S. Hrg. 100-15

THE FAIR DEPOSIT AVAILABILITY ACT OF 1987

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 344

TO REQUIRE DEPOSITORY INSTITUTIONS TO DISCLOSE TO THEIR CUSTOMERS THEIR PRACTICES RELATING TO THE AVAILABILITY OF FUNDS IN CONNECTION WITH CHECK DEPOSITS, TO REQUIRE THE TIMELY PAYMENT OF INTEREST ON DEPOSITS TO INTEREST BEARING ACCOUNTS, TO PROVIDE TIMELY ACCESS TO FUNDS DEPOSITED BY CHECKS, AND FOR OTHER PURPOSES

FEBRUARY 5, 1987

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THE FAIR DEPOSIT AVAILABILITY ACT OF 1987

THURSDAY, FEBRUARY 5, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
Washington, DC.

The committee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Christopher J. Dodd (chairman of the subcommittee) presiding.

Present: Senators Dodd, Shelby, Proxmire, and Chafee.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. Welcome all of you this morning to the very first hearing in 1987 of the Consumer Affairs Subcommittee. I'm going to express an apology to all of you to begin with. I'm suffering from what I guess everyone else in this town has had over the last couple of months and that is a terrible cold. My voice comes and goes, so I hope you will forgive me if I begin to rasp at some point or another this morning.

At any rate, I welcome all of you to the committee room and I would like to make just a couple of announcements if I could, so as much as it pertains to this particular hearing this morning but for the purposes of conducting business of the subcommittee not only today but in the future. I will make a request of all witnesses that appear before this subcommittee to have their prepared statements to the subcommittee 48 hours ahead of all hearings. I realize that's 24 hours longer than others, but because we are constrained from time to time on how much actual time we can give witnesses to testify orally, if we only have a short amount of time in which to review their statements we oftentimes don't ask the proper questions given the kind of information that has been presented by the witnesses.

So for the purposes of this subcommittee it will be 48 hours ahead of time and we will try, as other committees do, to restrain the amount of time so that we can get to questions and have a good discussion about the subject matter before the subcommittee.

And I would hope and ask that witnesses try and paraphrase or abbreviate their remarks to cover the basic main points that they would like the subcommittee to be aware of.

For the purpose of this morning we have expressed to all of you in writing ahead of time the amount of time per panel or per witness as the case may be. Obviously, I will try and be somewhat flexible in that. I think it's a bit constrained in some cases this morning, maybe a little bit too tight, but if it's possible to do it within those time constraints we'll try and live with it.

At any rate, I also wanted to express this morning what the agenda of this subcommittee will be over the next several months. After we finish considering the check hold legislation, I expect the subcommittee to examine two other pieces of legislation that have been considered by one or both of the Houses of Congress over the past 4 years—credit card disclosure and rate cap bills, and truth-in-savings legislation.

I don't have a timetable for hearings in those two matters, but I would hope over the next couple of months we would be able to have hearings on those issues and then move to mark up either as part of larger comprehensive bills or separately. Given the busy agenda, as you all know, of the Banking Committee and the limited resources of the subcommittee, I expect that it will take us about 3 or 4 months to complete consideration of these matters. I expect that we will look at the impact, in addition, of deregulation on bank customers as well as review how some of our existing banking consumer laws are working in this country.

Now it is with both pleasure and some considerable frustration I might add as well that I move to the topic of today's hearing.

In 1982, as many of you in this room will recall, I encouraged Senator Chafee, who was then the chairman of this subcommittee, to look at the issue of check holds. I did not ask for this hearing based upon any particular knowledge that I had about any study or specific information available, but merely based on the information that many of us who sit in Congress or are part of groups or institutions outside of the Congress of the United States were aware, and that is the countless stories people had heard about consumers who had had difficulty getting their checks cleared and the annoyance and the embarrassment of being told by retailers and others that their checks had bounced because of insufficient funds.

It was on that basis that I asked that we take a look at the issue. A March 1982 hearing revealed, as many of you will recall, that the Fed and the ABA had done a study in fact of check hold problems in 1979 and found that the practice of imposing long holds on check deposits was a widespread problem and suggested that banks should work to provide their good customers with access to their deposits at the same time that banks have the use of those funds.

At those hearings I suggested that I thought the Fed and the banking industry could solve the problem rather easily and I hoped that they would. Unfortunately, 1 year later, there was very little sign that my message and the message I might add of others of this committee had been heard.

Therefore, in February 1983, I introduced for the first time the Fair Deposit Availability Act. Since that time, the Senate has twice enacted check holds legislation and the House has done so once.

However, today, almost 5 years after the first hearing, bank customers too often are still faced with long holds. During this time of Federal inaction, some States have stepped into the breach to try and solve this problem. While there are limits to how completely States can address this problem, eight States have enacted laws restricting how long banks can hold checks and have demonstrated that it is possible to shorten those periods without increasing the risk of loss to the financial institutions.

While we are unable to have a witness from one of the States here this morning to discuss what has happened in those eight States, recently at a full committee hearing we had testimony from the National Conference of State Legislators which endorsed, at least in broad terms at any rate, the legislation that we are proposing in this area.

While I'm disappointed that we have not already solved this problem or have contributed legislatively to it, I don't think at all the time has been wasted. The bill that I introduced 2 weeks ago at the outset of the 100th Congress I believe is a better bill than the one that I introduced 4 years ago, and that is directly traceable, I think, to the knowledge that we have gained from both the State experience and the innumerable meetings and hearings with the Fed, the consumer groups, and the banking industry itself.

[Copy of proposed bill S. 344 follows:]

II

100TH CONGRESS
1ST SESSION

S. 344

To require depository institutions to disclose to their customers their practices relating to the availability of funds in connection with check deposits, to require the timely payment of interest on deposits to interest bearing accounts, to provide timely access to funds deposited by checks, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 20, 1987

Mr. DODD (for himself, Mr. PROXMIRE, Mr. D'AMATO, Mr. CRANSTON, and Mr. KERRY) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To require depository institutions to disclose to their customers their practices relating to the availability of funds in connection with check deposits, to require the timely payment of interest on deposits to interest bearing accounts, to provide timely access to funds deposited by checks, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Fair Deposit Availability Act of 1987".

DEFINITIONS

SEC. 2. As used in this Act—

(1) the term "Board" means the Board of Governors of the Federal Reserve System;

(2) the term "depository institution" means—

(A) any insured bank or domestic branch as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act, other than a foreign bank having an insured or uninsured branch;

(B) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(C) any savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(D) any insured credit union as defined in section 101 of the Federal Credit Union Act or any credit union which is eligible to make application to become an insured credit union pursuant section 201 of such Act;

(E) any member as defined in section 2 of the Federal Home Loan Bank Act; and

(F) any insured institution as defined in section 401 of the National Housing Act or any institution which is eligible to make application to become an insured institution under section 403 of such Act;

(3) the term "deposit account" means an account in a depository institution on which the account holder is permitted to make withdrawals by negotiable or transferable instruments, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. Such term includes demand deposit accounts, negotiable order of withdrawal accounts, share draft accounts, savings deposits, and share accounts. Such term does not include time deposits;

(4) the term "check or similar instrument" means a check, negotiable order of withdrawal, share draft, money order, or similar instrument, but does not include noncash items; and

(5) the term "United States" means the several States, the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

DISCLOSURE OF FUNDS AVAILABILITY POLICIES

SEC. 3. (a)(1) Before opening a deposit account, a depository institution shall provide a written disclosure to the potential customer of its specific policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account.

(2) In the case of a deposit account which was opened prior to the effective date of this section, the depository institution shall include the disclosure required by paragraph (1) with the first regularly scheduled mailing pertaining to the account which occurs after such effective date (but not later than 90 days after such effective date) unless the depository institution has provided a disclosure which meets the requirements of this section prior to such effective date.

(b) Each depository institution shall—

(1) post at each location where its employees receive deposits a clear and conspicuous notice setting forth its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument; and

(2) mail at least annually a brief reminder with respect to an account that deposits by check or similar instrument may not be available for immediate withdrawal.

(c) Each owner of an automatic or electronic terminal shall provide at each terminal location where deposits may be made a brief reminder that deposits by check or similar instrument may not be available for immediate withdrawal.

(d) A change to a depository institution's policy with respect to when customers may withdraw funds deposited by check or similar instrument into deposit accounts, other than a change which expedites the availability of such funds, may take effect only after the depository institution has provided notice of such change to its customers.

(e) Each depository institution shall provide disclosure, consistent with the disclosures required under subsection (a), by telephone of its policy with respect to when a customer may withdraw funds deposited by check or similar instrument into a customer's account upon the telephone request of any person.

(f) If a depository institution does not, as authorized by section 4(b), generally begin to compute interest or dividends on funds deposited by check or similar instrument to an interest-bearing deposit account or a time deposit on or before the date on which that depository institution receives provisional credit for the deposit (or if provisional credit is given on a nonbusiness day, the next business day), the depository institution shall provide a written disclosure, within the time periods required under subsection (a), with respect

to when the institution begins to compute interest on such funds.

(g)(1) The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of this section and to aid customers by utilizing readily understandable language. Nothing in this Act requires the use of any such model form or clause prescribed by the Board under this section. A depository institution shall be deemed to be in compliance with the provisions of this section if it—

(A) uses any appropriate model form or clause as published by the Board, or

(B) uses any such model form or clause and changes it by deleting any information which is not required by this Act, or rearranging the format.

(2) Model disclosure forms and clauses shall be adopted by the Board after notice duly given in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5, United States Code.

INTEREST ON DEPOSITS

SEC. 4. (a) For the purpose of computing the amount of interest or dividends payable with respect to an interest-bearing deposit account or a time deposit, a depository institution may not delay beginning to compute interest on funds deposited by check or similar instrument to such an account beyond the date on which that depository institution receives provisional credit for the check or similar instrument (or if provisional credit is given on a nonbusiness day, on the next business day).

(b) Subsection (a) does not apply to a depository institution which begins the computation of interest at a later date than required by subsection (a) for all deposits, including cash deposits, made to the deposit account, subject to the notice requirement of section 3(e).

(c) Nothing in this section requires the payment of interest with respect to funds deposited by check or similar instrument which is returned unpaid.

EXPEDITED FUNDS AVAILABILITY RULEMAKING

SEC. 5. (a) Not later than 48 months after the date of enactment of this Act, the Board shall promulgate regulations to expedite customer access to funds deposited by check or similar instrument either by improving the check clearing system in accordance with subsection (b) or by limiting the time period between the day of deposit and the day of funds availability in accordance with subsection (c).

(b)(1) The Board may promulgate regulations for the purpose of improving the check clearing system used by depository institutions by expediting the process for returning unpaid items or other means in order to ensure that receiving depository institutions can reasonably expect to learn of the nonpayment of any item within the time periods set forth in paragraph (3).

(2) In prescribing the regulations under paragraph (1), the Board shall consider —

(A) adopting a uniform endorsement standard;

(B) providing for direct notification of returning checks and similar instruments to the depository institution of first deposit;

(C) providing for direct return of checks and similar instruments to the depository institution of first deposit;

(D) providing for settlement of all returned checks and similar instruments through the Federal Reserve Banks, regardless of whether such checks or similar instruments are handled by the Federal Reserve Banks;

(E) extending limits for returns;

(F) the use of electronic means of collecting and returning checks;

(G) providing for check truncation;

(H) the establishment of an automated return system;

(I) charging a depository institution based upon notification that a check or similar instrument will be presented for payment;

(J) creating incentives for depository institutions to return unpaid items promptly to the depository institutions of first deposit;

(K) dispensing with unnecessary endorsements; and

(L) automating the reading of endorsements.

In prescribing regulations under this section, the Board shall balance the costs with the benefits of any improvements to be implemented.

(3) The regulation shall provide that no more than 4 intervening days shall pass between the day of deposit and the day of availability for funds deposited by check or similar instrument, except that the Board may extend by one business day the time period where such extension is necessary to carry out subsection (a). In any case, the Board shall differentiate time periods based on provisional credit periods plus return times.

(c)(1) The Board may promulgate regulations limiting the length of time within which funds deposited by check or similar instrument shall be available for withdrawal, based upon the number of days necessary to provide provisional credit, considering such factors as the type of instrument, type of institution, and geographic location

(2) The Board may, by regulation, establish reasonable exceptions to the time limitations established under paragraph (1)—

(A) for deposits by check or similar instrument into new accounts;

(B) for large dollar deposits by check or similar instrument in any one day;

(C) for checks or similar instruments that have been returned unpaid and redeposited;

(D) for deposit accounts which have been overdrawn repeatedly;

(E) for checks or other instruments drawn on institutions located outside the United States; and

(F) for any other class of checks or similar instruments if the Board finds, based on substantial evidence after notice and an opportunity for public comment, that such class poses a serious risk of loss to depository institutions and that an exception would substantially reduce such risk.

(d)(1) In accordance with regulations established by the Board, subsections (b) and (c) shall not apply to—

(A) any check or similar instrument where the depository institution has reasonable suspicion to believe that funds for the check or other item are uncollectable or receives a notice of a diversion or other delay in transit; or

(B) amounts deposited by check or similar instrument in a depository institution in the case of—

(i) any interruption of communication facilities;

(ii) suspension of payments by another depository institution;

(iii) any war; or

(iv) any emergency condition beyond the control of the receiving depository institution,

if the depository institution exercises such diligence as the circumstances require.

(2) The Board may, by regulation or order, suspend the applicability of this section, or any portion thereof, to any class of checks if the Board determines that—

(A) depository institutions are experiencing an unacceptable level of losses due to check-related fraud; and

(B) suspension of this section, or such portion of this section, with regard to the class of checks involved in such fraud is necessary to diminish the volume of such fraud.

A regulation prescribed or order issued under this paragraph shall remain in effect for not more than 45 days (excluding Saturdays, Sundays, legal holidays, or any day either House of Congress is not in session), and shall require that funds be made available within a reasonable time.

(3)(A) Within 10 days of prescribing any regulation or issuing any order under paragraph (2), the Board shall transmit a report of such action to the Committee on Banking,

Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate.

(B) Each report under subparagraph (A) shall contain—

(i) the specific reason for prescribing the regulation or issuing the order;

(ii) evidence considered by the Board in making the determination under paragraph (2) with respect to such regulation or order; and

(iii) specific examples of the check-related fraud giving rise to such regulation or order.

(e) In any case where subsection (c)(2) or (d)(1) applies—

(1) the depository institution shall provide immediate notice for deposits in person or, in the case of any other deposit, shall mail notice to the depositor not later than the close of the next business day following receipt of the deposit, as to the day the funds shall be made available for withdrawal and the reason the exception was invoked, except that—

(A) when the facts giving rise to the applicability of subsection (c)(2) or subsection (d)(1) occur after receipt of the deposit, the depository institution shall mail notice as soon as practicable; and

(B) when subsection (d)(1)(B)(iii) or subsection (d)(2) applies, notice shall be provided in accordance with regulations of the Board; and

(2) the availability of the funds deposited shall be governed by the policy of the receiving depository institution, but shall not exceed a reasonable period of time as determined by the Board.

(f) The regulations prescribed under this section shall become effective not later than 48 months after the date of enactment of this section. Except for any regulation under subsection (d)(2), such regulations shall only be adopted after notice and opportunity for public comment.

(g)(1) The Board shall establish an Expedited Funds Availability Council (hereinafter referred to as the "Council") to advise and consult with the Board in the exercise of its functions under this section. Any timely and specific recommendations proposed by the Council shall be considered by the Board prior to publishing regulations for comment hereunder.

(2) The Council shall consist of two representatives of the interests of depository institutions, two representatives of the interests of consumers, one representative of the interests of commercial depositors, and one representative of the interests of the technology industries. In addition, it shall include

representatives of all Federal agencies which regulate depository institutions.

(3) The Council shall meet from time to time at the call of the Board.

AVAILABILITY OF GOVERNMENT CHECKS

SEC. 6. In accordance with regulations prescribed by the Board, which shall be issued after notice and opportunity for public comment and which shall become effective not later than 48 months after the date of enactment of this Act, funds deposited at a depository institution by check shall be available for withdrawal not later than the date when the depository institution is given provisional credit for that check; or if provisional credit is given on a nonbusiness day, on the next business day, where the check—

(1) is endorsed only by the person to whom it was issued; and

(2) is drawn on the Treasury of the United States or the Treasury of any State or unit of general local government located in the same State as the receiving depository institution.

ADMINISTRATIVE ENFORCEMENT

SEC. 7. (a) Compliance with the requirements imposed under this Act shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act in the case of—

(A) national banks, by the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), by the Board, and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System and Federal savings banks), by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 5(d) of the Home Owner's Loan Act of 1933, section 407 of the National Housing Act, and section 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions; and

(3) the Federal Credit Union Act, by the Administrator of the National Credit Union Administration with respect to any Federal credit union or insured credit union.

(b) For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this Act shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may exercise, for the purpose of enforcing compliance with any requirement imposed under this Act, any other authority conferred on it by law.

(c) Except to the extent that enforcement of the requirements imposed under this Act is specifically committed to some other Government agency under subsection (a) of this section, the appropriate State regulatory authority shall enforce such requirements.

(d) The authority of the Board to issue regulations under this Act does not impair the authority of any other authority designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this Act.

CIVIL LIABILITY

SEC. 8. (a) Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under section 3, 4, 5, or 6 with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action, such additional amount as the court may allow, except that

Senator DODD. I believe we now have a balanced bill that I hope all sides can support, with some obvious reservations and some suggestions—positive and constructive ones, based on the testimony that I've read of witnesses who will appear before us this morning.

Nevertheless, I know of no reason why we shouldn't be able to in fairly short order get this legislation adopted and signed into law.

With that, I am delighted to welcome our very first witness this morning. I appreciate his being here. The Honorable Wayne Angell, who is a Governor of the Board of the Federal Reserve System. Governor, we are delighted to have you here with us this morning. We are delighted to receive your testimony. Your entire written statement will be made a part of the record and we would just ask if you can try and keep your remarks down to about 10 minutes or so and then we have some questions for you.

STATEMENT OF WAYNE D. ANGELL, GOVERNOR, BOARD OF DIRECTORS, FEDERAL RESERVE SYSTEM

Mr. ANGELL. Thank you, Senator Dodd.

I share your sense of frustration. We at the Federal Reserve understand what Members of the Congress want to do with the delayed availability problem. The problem has grown and it has become more difficult. Unfortunately, the check collection process does not work the way you and the American people would want it to work.

ELEMENT OF TRUST WORKS TWO WAYS

We understand that the banking relationship is one that historically involves an element of trust, and that element of trust works two ways. Ideally, customers and depositors do not write checks when funds are not there, and the banking industry gives the individuals availability before checks are returned. That indeed is the best system.

Now in a world in which we have a slow return process system, then someone is vulnerable. And if people wish to write checks prior to the time that they have a balance in their account, then we're going to have more return items than we otherwise would have.

I soon realized as a member of the Pricing Policy Committee at the Federal Reserve that we needed more authority to make the check collection system better. The fact of the matter is that the check collection system is hampered because in the District of Columbia and in two other States we cannot even have direct return items.

We believe, after a study has been undertaken, that we can return checks faster by a direct return process, but we cannot implement this without legislation. It's unfortunate that the Federal Reserve doesn't have this authority, but it is the first step that must take place to get the check collection system speeded up, particularly the return process.

If a check is returned to the institution upon which it is drawn and there are no funds there, ordinarily that check is returned along the route by which it came to the bank, and that return system is a very slow system. It's a slow system because it is not automated.

Now, there is also the fact that in many cases returned checks are returned by mail. Returning them by mail is also a very slow process.

The reason we need legislation is that the bank that benefits from getting the check back fast, the bank where the deposit was made, is not the one that incurs the cost. So in our experimental system we've had difficulty getting the banks to be willing to take a check, put it in a special envelope, microencode it to go directly back to the bank of first deposit rather than following the endorsement course on the back of the check. And we have to have legislation to get that done.

So in any bill we get, Senator Dodd, it is essential we have this authority. In either of the options in your bill, we need that authority.

At this point in time, that authority is only in the one option and so it's essential that we have the authority in both options.

SPEEDING UP THE CHECK COLLECTION SYSTEM

Now speeding up the return item system—we could make very big improvements, but some of the improvements will come at higher costs. We currently have a very low-cost check clearing system. We have to be careful that as we speed up that we do not make the costs so much higher that for persons with low-balance accounts that we make those accounts unprofitable. And we are very pleased that in your bill you allow what we assume to be 4 inclusive business days. I presume that business days will be added to that item because we could not do it if we had in a sense 4 days over a weekend or over a holiday period.

Senator DODD. I think you will find in the legislation we describe how those business days would work generally.

Mr. ANGELL. Yes. Well, thank you. I should have recognized that because it is important.

I am here to pledge to you that the Federal Reserve is considering this a priority item to improve the check collection system, particularly the speed of the return system. We can do much better, but we have to have legislation in order to do that.

The second thing that I might mention is that we believe that the system will work best and will be most efficient with the shortest return schedules if we have some flexibility in regard to implementation. Generally, we believe we can live with the 4 intervening business days if we have exceptions for certain kinds of items. For example, checks drawn on banks in other countries, we cannot make in the 4 business days with the present low-cost check operation system. We cannot make that schedule, for example, during a snowstorm, because airplanes get grounded.

But nevertheless, those exceptions are only a small proportion of the check items and we believe that we can speed this thing up and we can get it done and, in fact, Senator Dodd, I would be very, very disappointed if we do not have everything that you envision done way before 48 months. I appreciate your sense of patience and I want to suggest to you that I will have no patience whatsoever, Senator Dodd, for any slowdown in this process. I will have no patience whatsoever, Senator Proxmire, in letting the system go along as it's gone. It is imperative that we improve the system.

I would like to mention one last thing before we go to questions and that is the question about disclosure. I am somewhat concerned because there are banks out there that do provide for immediate availability and immediate availability is the best banking relationship there is. That is, the customer deposits a check and the customer immediately has available those funds.

Now we would understand that you might have to go to an officer to withdraw cash above a certain amount. We would understand that. We would understand that if you deposited a check in one branch and made a quick trip across town on the Metro and go to another branch that funds would not be immediately available because communication time has to take place. But immediate availability is something that most people understand and there are many banks that follow that practice.

We would hope that a disclosure system would not cause the banking system to worsen the availability. That is, we would hope that having a delayed availability schedule would not cause the banks to be motivated to say to people that have immediate availability, "Well, now, then, the law says we have 4 days on this and we have 1 day on this one, and so we are not going to give you immediate availability." Because it would be difficult for banks to send out a different notice and disclosure, the bank might say, "We'll just send out the same one to everybody and everybody gets longer availability."

So we would appreciate the opportunity for our staff to work with your staff to see whether or not we can have the disclosure limited to those banks that do not have immediate availability.

So, Senators Dodd and Proxmire, it is my highest priority to end this delayed availability problem so you do not get what we consider to be justifiable complaints that the system isn't working correctly. We will work fast. We are prepared. We must, however, have authority to get the checks going faster because writing legislation that gives deadlines, if deadlines can't be met, would run the grave risk of check kiting and check fraud and the banking system will react to that by denying accounts to people.

Senator Proxmire, I know as you have spent your career as an economist both in education and government, you understand better than anyone else that the American system works best when people have access to the banking system. People without bank accounts are disadvantaged in learning to be effective in our system. So I want to urge that rigid schedules that banks can't make are not part of the legislation. I am very appreciative, Senator Dodd, that your bill in a sense recognizes that problem.

Thank you.

[The complete prepared statement of Wayne D. Angell follows:]

the liability under this subparagraph shall not be less than $50 nor greater than $500; or

(B) in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the depository institution; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance, the resources of the depository institution, the number of persons adversely affected, and the extent to which the failure of compliance was intentional.

(b) A depository institution may not be held liable in any action brought under this section for a violation of section 3, 4, 5, or 6 if the violation was not intentional and resulted

from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a person's obligations under this Act is not a bona fide error.

(c) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation.

(d) No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

MISCELLANEOUS

SEC. 9. (a) For the purpose of this Act, any deposit which is made on a Saturday, Sunday, legal holiday, or after the close of business on any business day shall be deemed to have been made on the next business day.

(b) Whenever any provision of this Act requires that funds be available for withdrawal on a business day, such funds shall be available for withdrawal at the start of such business day.

EFFECT ON CHECK ACCEPTANCE POLICIES AND OTHER LAWS

SEC. 10. (a) Nothing in this Act—

(1) prevents a depository institution, in accordance with the policy of such depository institution, from making funds available for withdrawal in a shorter period of time than is provided in this Act or in regulations adopted by the Board; and

(2) affects a depository institution's right—

(A) to accept or reject a check for deposit; or

(B) if a check is accepted for deposit and the depository institution has made provisional settlement with the depositor, pursuant to law to—

(i) revoke the provisional settlement given by the depository institution;

(ii) charge back the depositor's account; or

(iii) claim a refund of such provisional credit.

(b) Any law or regulation of any State which requires that funds deposited or received for deposit in an account at a depository institution chartered by such State be made available for withdrawal in a shorter period of time than the period of time provided in this Act or in regulations prescribed by the Board under this Act shall—

(1) supersede the provisions of this Act and any regulations by the Board to the extent such provisions relate to the time by which funds deposited or received for deposit in an account shall be available for withdrawal; and

(2) apply to all federally insured depository institutions located within such State.

(c) Except as provided in subsections (a) and (b), the provisions of this Act or any regulation of the Board prescribed under this Act shall supersede the provisions of any State law, including the Uniform Commercial Code as in effect in any State, which the Board determines to be inconsistent with the provisions of this Act or such regulation, but only to the extent of the inconsistency.

REGULATIONS

SEC. 11. The Board shall prescribe regulations after notice and opportunity for public comment to carry out this Act. These regulations may contain such definitions, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, consistent with section 5(c) of this Act, as the Board determines are necessary to effectuate this Act, to prevent circumvention or evasion of this Act, or to facilitate compliance with this Act. The regulations of the Board shall require all disclosures, statements, and notices provided to be clear and conspicuous and in language that can be readily understood.

IMPROVING PAYMENT MECHANISMS

SEC. 12. Not later than one year after the implementation of any regulations under section 5, the Board shall prepare a study and submit its findings to the Congress on—

(1) the effect of the changes made by section 5, and the advisability and feasibility of further changes;

(2) an assessment of improvements that can be made in the check collection system, including improved procedures for the return of unpaid items, reduction of costs, reduction in the number of returned checks, greater speed and efficiency in the check collection and return system, utilization of more efficient technology, and parity of treatment of depository institutions; and

(3) an assessment of the use of electronics in payments and of the need for improvements in the way the payments system provides services so as to ensure efficient and affordable services, including the possible development of additional electronic services.

PARITY IN CLEARING

SEC. 13. (a) Section 11A of the Federal Reserve Act (12 U.S.C. 248a) is amended by adding at the end thereof the following:

"(e) All depository institutions, as defined in section 19(b)(1) (12 U.S.C. 461(b)(1)), may receive for deposit and as deposits any evidences of transaction accounts, as defined by section 19(b)(1) (12 U.S.C. 461(b)(1)) from other depository institutions, as defined in section 19(b)(1) (12 U.S.C. 461(b)(1)) or from any office of any Federal Reserve bank without regard to any Federal or State law restricting the number or the physical location or locations of such depository institutions.".

(b) The amendment made by subsection (a) takes effect on the date of enactment of this Act.

EFFECTIVE DATE

SEC. 14. Except as provided in sections 5, 6, and 11, this Act takes effect upon the expiration of 12 months following its enactment.

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For release on delivery
9:30 A.M., E.S.T.
February 5, 1987

Statement by

Wayne D. Angell

Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs

Committee on Banking, Housing and Urban Affairs

of the

United States Senate

February 5, 1987

Mr. Chairman, I welcome this opportunity to provide the views of the Federal Reserve Board on the issue of delayed availability, and specifically on S. 344, the "Fair Deposit Availability Act of 1987." We share your frustration with the check hold practices of some depository institutions and with the inefficiencies of the return item process. Therefore, we are eager to work with you and the Committee to devise a legislative remedy to the delayed availability problem. I am personally sympathetic with the goals of S. 344; my family experienced some of the problems faced by many consumers when we moved from Kansas to Washington last year.

Legislation addressing the delayed availability issue should contain two essential elements. First, additional regulatory authority is needed to make improvements to the check collection and return process, thus reducing or eliminating the risk to depository institutions of making funds available more promptly. Second, there is a strong and straightforward case that depository institutions should clearly disclose to consumers their policies if they delay availability of deposited funds.

S. 344 also contains a third element -- schedules that dictate the maximum holds that a depository institution may place on the proceeds of deposits. The Federal Reserve Board believes that mandatory schedules raise difficult problems in minimizing risks to depository institutions and maximizing consumer benefits. We have felt primary emphasis should be placed on disclosure and payment system improvements. However, the Board does believe that availability schedules could be a workable component of the delayed availability legislation. S. 344 contains the basic elements to achieve an effective availability schedule.

Expedited Funds Availability

Availability schedules should be designed so as not to encourage check fraud, by basing the schedules on the time normally needed to clear and return checks. Although this time period is currently lengthy, it can be shortened to provide for relatively prompt availability schedules if the Board is given additional authority to implement initiatives to expedite the check collection process.

The Board is concerned that requiring availability before the receiving institution can reasonably be expected to learn of the return of an unpaid check will encourage check fraud, including kiting. It would be relatively easy to perpetrate a check fraud under a system where institutions are required to make funds available to customers before there is any opportunity to learn of nonpayment.

If an individual knows that funds must be made available before a check can be returned, all he would have to do is to open accounts at two local institutions. Both accounts would be maintained in a proper manner for sufficient time to satisfy any new account exception. After that time, suppose the individual writes a check subject to the availability schedule against

nonsufficient funds on his account in one institution and deposits it in his account at the other institution.

If the schedules are too stringent, the institution in which the check was deposited would be required to make the funds available to the individual depositing the check before learning that the item will be returned unpaid. If the individual withdraws the funds and leaves before the check is returned, that institution would be unable to charge the check back when it ultimately receives the return item, and it would suffer a loss for the amount of the deposit. Similar schemes involving dozens of institutions could be easily accomplished.*

While we recognize that this type of check fraud can occur today, requiring funds availability before the completion of the normal collection and return cycle will tend to encourage this type of check fraud. This is not to say that mandatory schedules must accommodate the return of all checks, but rather that the schedules should not be designed so that individuals can rely on obtaining availability before the check is returned.

If mandatory availability schedules are adopted, the

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* Attached are two series of charts depicting the timing of the check collection and return item process. The first two tables contain data regarding current return item practices. The following four diagrams depict the best case timing of the check collection and return item process. With improvements to the check collection system, these times could be achieved for a substantial portion of the checks collected; however, handling errors or delays in transportation would result in longer collection and return times for some checks.

TABLE 1

Distribution of Average Collection Times For Returned Checks

Average Days From Date of Deposit To Date of Return	Percent of Return Items	Cumulative Percent
1	1%	1%
2	4%	5%
3	12%	17%
4	10%	27%
5	15%	42%
6	17%	59%
7	14%	73%
8	8%	81%
9	4%	85%
10+	15%	100%

Source: BAI Return Item Study, 1985

TABLE 2

Distribution of Number of Endorsements For Returned Checks

Number of Endorsements	Percent of Return Items
2	4.0%
3	52.0%
4	30.5%
5	10.7%
6+	2.7%

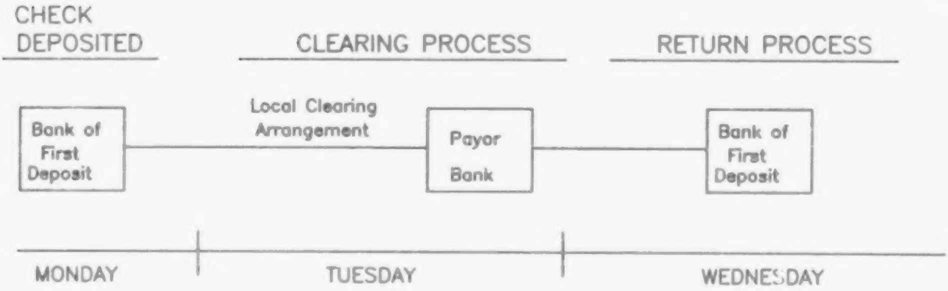
Percent Returned Via Mail -- 11.45%

Source: Industry/FRB Return Item Test, 1986

TABLE 3

Check Drawn on Payor Bank Located in Same City As Bank of First Deposit

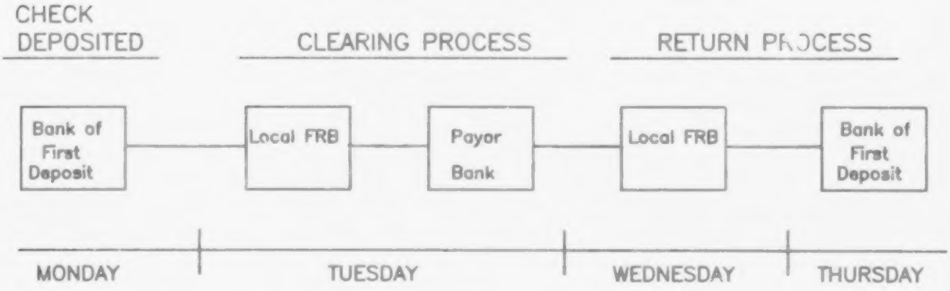
(Two Clearinghouse Banks)


CHECK DEPOSITED
CLEARING PROCESS
RETURN PROCESS
Bank of First Deposit
Local Clearing Arrangement
Payor Bank
Bank of First Deposit
MONDAY
TUESDAY
WEDNESDAY

Best case situation.

TABLE 4

Check Drawn on Payor Bank Located in Different City But Same Federal Reserve Territory As Bank of First Deposit

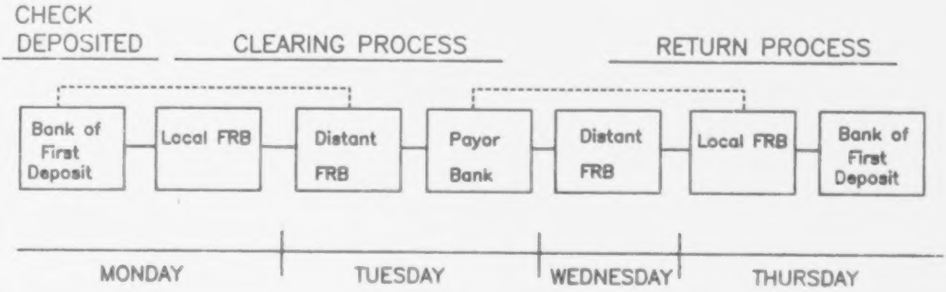

CHECK DEPOSITED
CLEARING PROCESS
RETURN PROCESS
Bank of First Deposit
Local FRB
Payor Bank
Local FRB
Bank of First Deposit
MONDAY
TUESDAY
WEDNESDAY
THURSDAY

Best case situation, after implementing improvements to the return item system.

Additional days will be added to cycle if a correspondent bank or country bank are involved.

TABLE 5

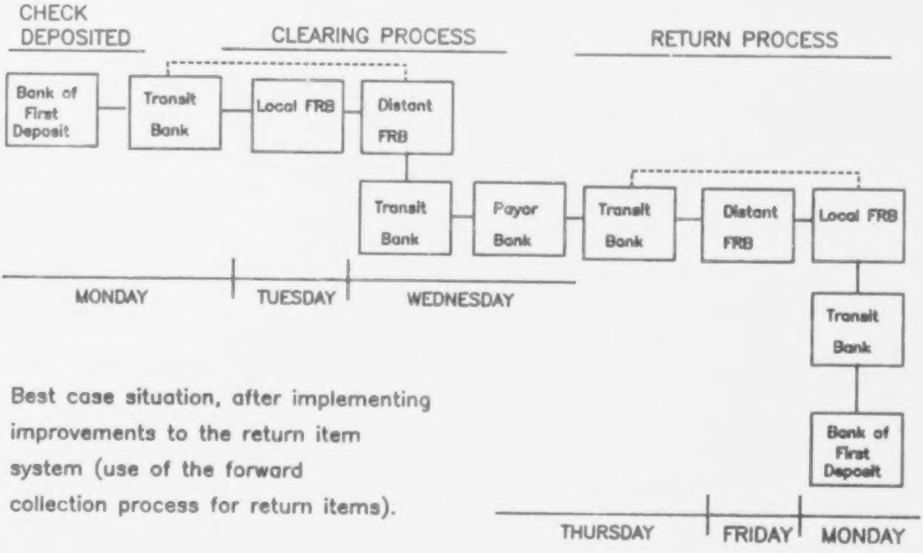
Check Drawn on Payor Bank
Located in Federal Reserve Territory
Distant from Bank of First Deposit


CHECK DEPOSITED
CLEARING PROCESS
RETURN PROCESS
Bank of First Deposit
Local FRB
Distant FRB
Payor Bank
Distant FRB
Local FRB
Bank of First Deposit
MONDAY
TUESDAY
WEDNESDAY
THURSDAY

Best case situation, after implementing improvements to the return item system (use of the forward collection process for return items).

TABLE 6

Check Drawn on Payor Bank
Located in Federal Reserve Territory
Distant from Bank of First Deposit
Both Serviced by Correspondents


CHECK DEPOSITED
CLEARING PROCESS
RETURN PROCESS
Bank of First Deposit
Transit Bank
Local FRB
Distant FRB
Transit Bank
Payor Bank
Transit Bank
Distant FRB
Local FRB
Transit Bank
Bank of First Deposit
MONDAY
TUESDAY
WEDNESDAY
THURSDAY
FRIDAY
MONDAY

Best case situation, after implementing improvements to the return item system (use of the forward collection process for return items).

Senator DODD. Thank you very, very much, Governor. Let me, first of all, if I can, include in the record the opening statement of Senator Gramm, who is the ranking minority member of this subcommittee and is unavoidably at another committee hearing this morning and will try to get by if he can, but he would like his statement included in the record and we will see that that's done.

[The complete prepared statement of Senator Phil Gramm follows:]

OPENING STATEMENT OF SENATOR PHIL GRAMM

Mr. Chairman, the Consumer Affairs subcommittee today begins its examination of your bill, S. 344, the Fair Deposit Availability Act of 1987. The prominent place of this issue on the Subcommittee agenda undoubtedly reflects the high importance you attach to it.

I think that there are several principles that must guide us as we look at this legislation.

To my mind, increased Government involvement is not likely to speed up any economic process. I fear that inserting government regulation into the check clearing process may in the end create greater delays, for inevitably along with the regulations come regulators, and behind them come lawyers and courts.

I am also concerned that if we are not careful we may repeat mistakes of the past. We must avoid creating, in the name of consumer interests, an expensive consumer and bureaucratic nightmare.

Let's look at an example from the not so distant past. Several years ago complaints were raised that the loan information provided by financial institutions to borrowers was inadequate, that there were too many hidden terms and conditions. So Congress passed the Truth in Lending Act. The result was a paperwork mess that did nothing to disclose information to the consumer. In fact, the consumer was more confused than ever. The situation was so bad that the Congress later had to pass the Truth in Lending Simplification Act.

With this new legislation we must avoid creating a new monster that consumers, bankers, and everyone else will be forced to live with until we can come back later and fix it. And in the process we may still not get any closer toward solving the original problem.

I am not saying that there have not been problems. But when I am dissatisfied with the service that I get from my bank, then I look for another bank. I think that we can expect the American consumer to act in the same way. That is the driving element to the market place, and market, competitive drives can be a powerful force toward resolving this and many other problems. We should seek to do what we can to employ those forces, to free them up. Perhaps there are obstacles in their way that need to be removed. Certainly we should do nothing in this legislation to get in their way.

I can support increasing information. Competition thrives on information. But what happens when Government gets involved in prescribing the information, its form and content? I am skeptical that the flow of information improves.

These are some of the principles that will guide my consideration of this legislation. I look forward to the comments of the witnesses before us today.

Senator DODD. I'm delighted also to welcome my chairman, Senator Proxmire, who's here this morning. Bill, do you have any opening statement you would like to make?

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. As chairman of the full committee, I am delighted that Senator Dodd has scheduled these hearings on deposit availability issues—issues that affect millions of Americans every day.

The existing system for returning unpaid checks is cumbersome and archaic. It's bad for consumers and bad for banks. I believe that the system can be dramatically improved through measures such as direct return or direct notification. Such improvements, coupled with disclosure of banks' check-hold policies and with protections against excessive check holds, could yield substantial benefits to consumers without imposing unreasonable burdens on banks.

I hope that this hearing will help the full committee reach a consensus on deposit-availability issues. I intend to include provisions dealing with those issues in the bill that the committee will mark up later this month. I look forward to benefiting from the views expressed in this hearing and from the subcommittee's recommendations.

Senator **DODD**. Thank you.

Governor, let me just ask you a few questions. First of all, let me thank you for your testimony. It is most constructive and I appreciate personally your very kind remarks about the legislation. We haven't always had as much support. I must say as well, Chairman Volcker, when he appeared before Senator Proxmire and the full committee, in his testimony was also very supportive of legislation in this area and I'm very grateful. I know that at least the majority of us on the committee are very grateful for that support as well.

LEGISLATIVE AUTHORITY TO IMPROVE PAYMENT SYSTEM

Just a couple of questions. One, you suggest that you need some legislative authority in order to have checks returned directly from the payor bank to the depositing bank in order to implement that kind of a program.

I wonder if you might just get a bit more specific about how this would work and let me lump a couple of questions together. How would it work? How costly is it? The question that comes to the mind to this layman, if you will, in discussing this is that every payor bank I suppose you could argue is a depositing bank and every depositing bank is a payor bank, at least in some sense. So while you are correct that the payor bank would incur the costs, the depositing bank would also be a payor bank at some point and wouldn't that necessarily at one point or another sort of level itself out in terms of cost? I'd like you to respond to all of these if you will. How long would it take to implement such a system in your mind if we did adopt legislation such as you suggest as a part of this bill? How long a time would it take to actually put that in place? Those three or four questions.

Mr. **ANGELL**. Yes. As you well know, the check is microencoded with the payor bank's routing number and the first bank that receives the check microencodes the amount. The customer's account number that the check is drawn on is already microencoded, and high-speed machines sort the checks by payor bank.

The payor bank when it receives the check must make a decision whether to pay the check. If there are no funds in the account, then the bank will return the check.

The thing that banks do is to look at the endorsement on the back of the check, which is difficult. I have a hard time even reading them. I congratulate all the people in the check return process who are able to somehow or other read these endorsements stamped all on top of each other, and that's a slow and cumbersome process.

So direct return doesn't necessarily increase the total cost. Direct return simply increases the cost on the bank that starts the system because that bank then has to have someone make a decision, put the check in an envelope, and seal the envelope and microencode it with the routing number of the bank of first deposit.

Now that might cost that bank maybe up to 50 cents because this is a manual process. Once that encoding is done, then everybody else can treat it as a very low-cost item which can be costing somebody a few cents to process. This will go back fast on the most direct route once we get this done.

Now this system—we've already run this return item test. They did that, Senator Dodd, even before I became a member of the Board of Governors. I think this Board of Governors is determined to do this thing, and we do have to give credit to those that were before us and the staff of the Federal Reserve who worked with the American Bankers Association on this program. The American Bankers Association has been very cooperative with us.

So what we have to have is this return item envelope and we have to ask the banks to all go out and buy enough return item envelopes from their suppliers. There are some who are optimistic who think that maybe in 9 months or 1 year after the legislation is passed we can start implementing this program. There are others who think it might take longer than that.

But the most important thing is for you to understand that the Federal Reserve now is going to give this the highest priority. Now that doesn't mean we're not going to watch the money supply numbers. But we are going to give this a very, very high priority and in my responsibility with the Board's Bank Activities Committee and working with the Federal Reserve Banks, we are going to leave no stone unturned and the people that are sitting here behind me all have responsibility to me to see that we get it done quickly.

Senator DODD. Did you say storm or stone unturned?

Mr. ANGELL. Well, either one. Storms we don't control, unfortunately. But the main thing is, even when we have a storm, we want check writers to understand that their checks are going to get back fast. The faster everyone expects these checks to get back, the less likely we are to have a fraud or check kiting problem.

Senator DODD. Because we have several members here and I don't want to take up all the time, let me turn to Senator Shelby.

Did you have any opening statement, Dick, that you wanted to make?

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Thank you Mr. Chairman. As a new member to the consumer subcommittee, I am pleased to participate in this important hearing on S. 344—an issue that I know our chairman, the Senator from Connecticut has been working diligently on for several years. I admire his tenacity on behalf of the American consumer. There is a great deal of congressional history in this area, and I am glad to have the opportunity to help shape a responsible solution this year to a problem that has been plaguing the American consumer for decades.

We live in a modern, advanced society. Telecommunications today have taken us far beyond the limits of telephone lines and postal routes to the age of instant information—instant access.

We see this revolution integrated into every facet of our society—from the local dry cleaners to the worldwide mass media.

It seems to me we ought to have an equally sophisticated banking system. A system that reflects the enhancements of our computer generation.

We certainly ought to have a banking system that services the large contributers as well as the small client—the average consumer.

Yet, reports lead us to believe that this isn't the case. That, in fact, the low- and middle-income customer is being increasingly inconvenienced by bank policies.

Greater and more injurious penalties face the smaller, more vulnerable consumer. I'm concerned about the elderly on fixed incomes. I'm concerned about the working people with limited resources. These are the people most harmed by the decades-old check hold process we're studying today.

So, I'm pleased we have an opportunity today to hear from several witnesses—all who have a stake in resolving this issue in a timely and responsible fashion.

Thank you.

Senator **Dodd**. Thank you.

Senator Proxmire.

Senator **Proxmire**. Thank you, Mr. Chairman.

Governor Angell, lengthy check holds have been a source of concern for over a decade, as you know. Many of us in the Congress had hoped the Federal Reserve Board would take the lead in improving the check clearing system and recommending whatever legislation might be necessary, but the Board took its time studying the matter and played down the need for legislation.

You made a very impressive statement this morning and you've told us with great emphasis that you think that the Board will act, and I know how strongly you feel personally about it. I can certainly tell that from your testimony.

FED FULLY SUPPORTS S. 344

But what assurance can you give us that the Board as a whole—you, after all, have one vote and there are seven members of the Board—the Board as a whole would implement legislation as S. 344 energetically, expeditiously, and in full accord with the spirit of that legislation?

Mr. **Angell**. Well, just to give you an example of the commitment of the Board to this, last Monday when we had the snowstorm and all of the Government was shut down, the Board of Governors met with all members present and discussed my testimony to be delivered before Congressman St Germain's committee, which was the same vein as this. The entire Board on that day agreed with the testimony. So the testimony that I gave then and that I give now has the full support of the Board. So I have no doubt current check collection and return cycle must be shortened in order to provide the most expeditious availability to consumers while limiting the risk of increased check kiting. Federal Reserve authority to make needed improvements in the check system is crucial to accomplishing this objective, as well as to improve the check collection system generally and thereby reduce the risk to institutions from returned checks, even if those checks are not covered by mandatory availability schedules. Today, the Federal Reserve's regulatory authority generally applies only to those checks that it clears. While the Federal Reserve has devoted significant attention to improvements in the return item process, our lack of regulatory authority has lessened our effectiveness to make significant progress in this arena.

If legislation is passed, under section 5(b) of S. 344 the Board would propose several initiatives to improve the return process. One such initiative that the Board might propose would be to require the payor institution to return checks to the institution of first deposit within a specified time frame. This requirement would effectively prohibit the use of the mail for most return items. The mail is now used for over 11 percent of returns, slowing the trip back to the depositing institution by up to several days. This requirement would expedite returns at relatively little cost to the industry, but would be effective only if it were applicable to all checks, regardless of how they are cleared.

This initiative could also entail permitting institutions to return checks directly to the institution of first deposit, bypassing intermediate endorsers. This practice is not authorized by three jurisdictions, but section 5(b) would provide the Board with the authority to preempt the laws of these jurisdictions, thus making the use of direct returns feasible on a widespread scale.

A further initiative involves the automation of return items through the use of the same efficient mechanism used to collect checks. A recent test of this concept by the Federal Reserve, the American Bankers Association and seventy five depository institutions proved quite promising, reducing the time to return checks by an average of more than one third. However, the cost of this program falls on the institution that is returning the check, while the benefits of the expedited return accrue to the institution of first deposit. Therefore, its use is not likely to be widespread without the Federal Reserve having the authority to create incentives for payor institutions to participate in the program.

These examples illustrate the steps that could be taken to accelerate the return of checks, if additional regulatory authority were granted to the Board. This authority should be sufficiently broad to enable the Board to consider not only the specific initiatives contained in the legislation, but also additional proposals, perhaps not envisioned today.

With these improvements to the check collection system, a relatively prompt availability schedule would be possible. A schedule of no longer than four intervening business days, with an additional business day added when determined necessary by the Board, would be workable. Therefore, to the extent that the schedule in section 5(b) of S. 344 is based on business days, it sets a realistic goal for availability of all checks. Because many local and regional checks are collected more promptly, the Board would adopt more expeditious schedules for the large majority of checks. Under this schedule, depositors seeking to perpetrate a fraud would not be able to rely on obtaining availability before the check is returned.

If the Board implemented the expedited availability system under section 5(b), it would have the authority to establish only very limited exceptions to the schedules. However, even under an expedited system, not all checks will be returned within the time frames established for availability. Therefore, it is important that any mandatory availability schedules adopted contain adequate authority for the Board to establish exceptions, not only for instances where the institution has specific reason to doubt the collectability of an individual check, but also for those classes of checks that may impose increased risk, even though the individual check raises no particular suspicion that it is uncollectible. For example, it may be necessary to provide an exception for foreign checks,

since the receiving institution will not learn of the nonpayment of these checks within the time frame established in the bill. Similarly, general exceptions for new accounts, large dollar deposits, and other types of checks as recognized in section 5(c) of S. 344, may also be warranted.

In summary, the expedited availability approach taken in section 5(b) of S. 344 provides the needed authority for the Federal Reserve to improve the check system, and provides the Board with sufficient flexibility in setting the availability schedules so as to not encourage check kiting schemes. However, it is essential that these schedules allow for exceptions for limited classes of checks, as provided in section 5(c)(2) of S. 344. With the addition of these exceptions, and certain other technical changes, we believe that the approach taken in section 5(b) would ensure that customers obtain prompt availability on the funds they deposit, without exposing depository institutions to significant risks.

In contrast, the approach taken in section 5(c) of the bill, which calls for availability at the time of provisional credit, subject to broad exceptions, would likely result in increased check fraud, since institutions would be required to provide availability before any opportunity to learn of the return of the unpaid item. In addition, this alternative does not give the Board the authority to expedite the check system, and thus does not address one of the underlying causes of the delayed availability problem.

Disclosures

As I stated earlier, disclosures are an essential element in any delayed availability legislation. However, we believe that the disclosure provisions in S. 344 can be made more flexible, particularly for those institutions that do not routinely place holds on deposits. For example, an alternative could be provided for these institutions, in which notice would be required when a hold is placed on a given deposit that falls within one of the exceptions of the bill. This notice requirement would be in lieu of the disclosure requirements. This approach would significantly lessen the compliance burden on institutions that, except in rare situations, do not delay availability. For institutions that do regularly place holds on their customers' deposits, the disclosure requirements set forth in S. 344 would apply.

Further, the Subcommittee may wish to also consider limiting the disclosure requirements to consumer accounts. Providing the required disclosures for all corporate accounts would be a very complex undertaking, since the availability of deposits is often tied to the level of required clearing balances and other account terms. Corporate accountholders are typically far more familiar with their institution's availability schedules than are consumer accountholders. Even with this limitation, a number of small businesses may, as a practical matter, still be given the disclosures required by the bill. Given the potential civil liability for failing to follow the requirements for consumer accounts, many institutions would likely simply treat small business accounts as consumer accounts to avoid a time-consuming process of distinguishing between the two.

Finally, there are a number of other provisions of S. 344 that bear further consideration. Under the bill, the Board's authority to make payment system improvements could be construed to expire after 48 months. The Board should be given continuing authority to make further improvements to the check system, and to modify the availability schedule if warranted by these improvements. The Board is also concerned that the requirement for establishing an Expedited Funds Availability Council may slow rather than facilitate payment systems improvements. The Council would duplicate the responsibilities of several other groups, such as the Consumer Advisory Council, which are already in existence. In addition, there are other technical amendments we would like to propose. The Board staff will be pleased to work with your staff to develop the most effective legislative remedy to the delayed availability problem.

In summary, we believe that legislation that requires disclosure, and provides authority to the Federal Reserve to improve the return item process and establish availability schedules will be beneficial to consumers and ensure that the costs to the banking industry are reasonable. Again, I am pleased to be here today and would be glad to discuss the delayed availability issue in more detail as the members of the Subcommittee desire.

Attachment

whatsoever that the view that existed previously no longer exists and everyone understands, and we believe that the banking industry, as I presume they will testify later, understands that the American people and the American Congress will not be satisfied with delays. And any further delays on our part is more apt to result in legislation that spells out deadlines rather than giving us the flexibility to move the deadlines down as the payment system speeds up. And we believe that we can get the best program possible through our giving the emphasis that you and your committee and the House committee have clearly wanted from us previously.

But we would like to do it in a manner that will have the lowest cost possible and in a manner that will reduce the likelihood that individuals will be denied access to the banking system.

Senator PROXMIRE. Thank you very much, Governor Angell.

Governor Angell, you, of course, are not from the District of Columbia area. You're from Kansas and there are other members of the Board who are also used to tough winters and high snows, so the weather we've had so far has been a piece of cake for people like you I'm sure. The fact that they all showed up is good to hear, that they're all earning their pay, but after all, it wasn't that much of a snowstorm really, was it?

Mr. ANGELL. Well, it was really quite easy because I have an apartment above Highway 50 and I looked down——

Senator PROXMIRE. That was my second question. You also live right nearby?

Mr. ANGELL. Yes, I live nearby.

Senator DODD. Marion Barry I think endorses your statement as well, Senator Proxmire.

Senator PROXMIRE. Well, of course, he did that from Pasadena, CA I'm sure.

What justification is there for placing a hold on a Government check or a cashier's check beyond the time needed for the bank of deposit to get provisional credit for the check?

Mr. ANGELL. The justification is that sometimes we do have forgeries involved in those checks.

Senator PROXMIRE. Now wait a minute. If forgery is the issue, it's hard to see how a hold will help. It won't uncover the forgery and it won't cure it either.

Mr. ANGELL. I think you're correct. It takes a longer time, but that problem, of course, motivates some banks to place holds on checks.

I would mention to you, Senator Proxmire——

Senator PROXMIRE. Why should there be a hold then on a Government check or a cashier's check? You know it's good.

Mr. ANGELL. We believe there should not be holds on Federal Government checks.

MONEY MARKET MUTUAL FUNDS CHECKING ACCOUNTS

Senator PROXMIRE. Now the ABA proposes on pages 7 and 8 of their testimony this morning that the provisions of S. 344 be extended to money market mutual funds that can be used like checking accounts.

Do you agree?

Mr. ANGELL. If you receive a check and it's drawn on a money market mutual fund, it is often payable through a draft, and therefore the return process may be slower.

So it would seem to me that these items are different items, that a check is a check and in a sense a sight draft or a money market mutual fund would take a longer time to return.

Senator PROXMIRE. Well, my time is up. I hope that when the ABA witness comes up, Mr. Monks, that he will respond to that because he may well disagree with you.

Mr. ANGELL. Well, I think it's very important that we do—if we're going to have money market mutual funds be like checks, then there ought to be accounts held at the Federal Reserve Bank and there ought to be reserves for that.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator DODD. Thank you.

Senator PROXMIRE. May I ask unanimous consent that the remainder of my questions be submitted?

Senator DODD. Absolutely. Without objection, so ordered.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Some of the consumer groups' testimony has expressed a concern that we should not merely provide the 4 intervening days outside the time limit, but that we should address the question of a shorter period for local checks because the Fed could choose to apply the new system to out-of-State checks only.

Would you antiticpate that the Fed would have shorter hold requirements on local checks or checks that would take as long to process?

Mr. ANGELL. The Federal Reserve is committed to having a flexible schedule in which the number of days of hold would be dependent upon certain categorizations.

Senator SHELBY. For example, how would it work?

Mr. ANGELL. How it would work is, if you have a check that is a local check drawn on a bank in the same clearing house, perhaps a 1 intervening business day hold is all that would be justified.

For checks within the same Federal Reserve territory, the time might be 2 intervening business days. We would need the 4 intervening business days by and large for checks that are drawn outside the local area and have to go through more than one Federal Reserve district, which adds another day. If country banks and two Federal Reserve districts are involved, even more time may be warranted.

Based on the normal collection and return times in the improved system, we can publish schedules and alter the schedules as we develop further innovation. This is preferable to looking ahead and writing it into law precisely for every category. We are committed to do just that.

Senator SHELBY. The whole thing is based on information, is it not?

Mr. ANGELL. That's correct.

Senator SHELBY. OK. Well, we've had an explosion of information in the last 10, 15, 20 years, and it's going to get more and more into an electronic banking era.

Most of these country banks—and, of course, I come from Alabama and we certainly have some left there—aren't most of these banks tied into some kind of electronic clearinghouse with the Fed?

TWO ELECTRONIC SYSTEMS

Mr. ANGELL. Yes, that is correct, and that alternative is becoming increasingly available and increasingly used. We operate several payment systems. One is the wire transfer system. When you make a wire transfer, the funds are debited immediately from the sending institution's account, and the Federal Reserve guarantees those funds to the receiving bank.

We also have a system called the automated clearinghouse system, for the social security and other payments.

Senator SHELBY. What percentage of the funds are done that way? Do you have any statistics on that?

Mr. ANGELL. Well, 95 percent of the payments are made by paper checks. The speed of processing is limited due to the fact that the payments are paper based. We do not know of innovations around the corner that are going to speed up that dramatically other than getting the return process.

I understand that, in terms of the dollar value of the transfers, 86 percent are now done by the wire process. But 95 percent of the items are paper.

Senator SHELBY. What's the intervening time on the wire process on the 86 percent? Is that instantaneous?

Mr. ANGELL. That same day, because if it's a Fed wire——

Senator SHELBY. Within a working day?

Mr. ANGELL. That's correct. If it's a Fedwire, when the Federal Reserve Bank notifies the bank that they have received a transfer, the Federal Reserve has guaranteed those funds. So they are available immediately and I know of no instance of any bank holding up availability on incoming wire transfers.

Senator SHELBY. Do you think we can legislate from the Congress how we're going to increase this flow of information or do you think it should be done that way?

Mr. ANGELL. Senator, the Senate bill wisely gives us direction and then asks us to implement the bill's objectives. We understand your frustration out of our slowness to move faster since 1977. However, we need the authority to develop the best system possible, subject to all the innovations we can adopt. We are going to spend money on research to do it the best we can.

Senator SHELBY. But you're admitting that for 10 years you've done hardly anything, right?

Mr. ANGELL. Well, I wouldn't suggest that. In defense of those who went before me, we did do the "Michigan Consumer Research Survey" and we did find what we thought was only a small proportion of consumers who had a problem, but we were wrong by using the consumer survey process as comparison to using what you in the Congress so quickly get and that is people who call you and write you letters and tell you about the problem, and we believe you. There is a problem. And we have made a number of improvements to the check system.

Senator SHELBY. Well, we believe there's a problem out there, too. Thank you. My time is up.

Senator DODD. Thank you, Senator Shelby.

Let me if I can ask two additional questions. You noted in addition to the request, Governor, for some additional legislation to implement this more direct approach that would speed up the process, you also talk about the need for some exceptions. You talk about foreign checks. Again, the legislation excludes foreign checks as an exception automatically under the legislation.

But it sounds to me like it's one or the other. What is the need for exceptions if in fact you get what you suggested in the first point of your testimony, and that is a more direct expedited process? It would seem to me that if we give you that, then the need for exceptions becomes moot. Or are you suggesting that if we don't give you the former, then exceptions is what you need? You're not suggesting that you need both?

Mr. ANGELL. Well, the tradeoff is not between authority and exceptions. The tradeoff is between rigid schedules and exceptions. We need authority to improve the check system under either approach, but if you give us rigid schedules we will have to have more exceptions. If you give us more flexible schedules, we then won't have to make as many exceptions because we can modify our own schedules when improvements are made.

Senator DODD. I understand that. But as you know, in the legislation we're not giving you rigid schedules.

Mr. ANGELL. I appreciate that.

Senator DODD. But what you have suggested is that, of course, you would need some additional legislation in order to have the power to expedite the process.

Mr. ANGELL. That's correct.

Senator DODD. If we give you that, then it would seem to me, based on your response to Senator Shelby's questions and your own testimony, that you should be able to reduce this time considerably, certainly by as much as 50 percent or more, it would seem to me, over present day practices. If that is the case, then it would seem to me that the request simultaneously for exceptions becomes moot. That's my point. Not the rigidity of the schedules, but that the legislation to have a more direct and expedited process would eliminate the need for the broader exceptions you talked about?

Mr. ANGELL. While you haven't specified all the schedules, this bill does set out 4 intervening business days and there are some cases where we cannot get information back within 4 intervening business days. So we will either need more than 4 intervening business days or we need exceptions.

Now that's what the tradeoff is. So if you give us more than 4 intervening business days by the law, then we will narrow it down where we can. But the fact of the matter is, that we probably can't make it in 4 intervening business days if we have a check drawn on a Connecticut bank that is going to be deposited in a Montana bank in eastern Montana that's got to go to Helena, we probably can't make that in 4 business days. So we might thereby need more exceptions.

Senator DODD. We allow a fifth day, as well, as you know.

Mr. **Angell**. We understand that, and that almost gets us there. Now we, of course, need exception for good faith and we need an exception for the new accounts.

Senator **Dodd**. Let me ask you one other question if I can. You avoided the discussion of the local checks, not the interstate but the intrastate question here. I wasn't necessarily suggesting that the Fed be responsible for the intrastate, but I wonder if you have any comments or suggestions in that area?

INTERPAYMENTS DISTRIBUTION SYSTEM

Mr. **Angell**. OK. Our suggestion would be that the distinction should not necessarily be intra- or interstate, but rather if the check was processed by more than one Fed office. That is, if we have a check that's deposited in an institution in southwest New Mexico and would clear through the El Paso branch of the Federal Reserve Bank of Dallas, and is drawn on a bank in Las Vegas, NM, which clears through the Denver branch. So it really isn't a question of just interstate, but rather inter-Federal Reserve territory, which we believe we can spell out quite clearly for the banking system and for depositors.

Senator **Dodd**. Then in the hold periods on intrastate situations, do you have any suggestions in terms of hold periods where you're dealing in a single State, even a large State like Texas or California?

Mr. **Angell**. Well, in the example of New Mexico, we probably couldn't meet 2 intervening business days. But for most local checks, I can't imagine needing longer than 2 business intervening days and for local clearing house checks, 1 intervening business day.

Senator **Dodd**. You've made a suggestion which I agree with here and that is, of course, we ought to provide you with continuing authority in the Fed in this area and I think that's a wise suggestion and one that we will incorporate in the legislation as well.

Last, you, of course, raised the question that's raised all the time and that is the fraud question, which legitimately the banks raise as a concern of theirs, and I don't minimize the importance of that, particularly the fraud problem if we don't clean up the return process and make it a more expeditious one.

Now there are many States that, of course, have very short hold periods. Based on any information you may have, is there any larger incidence of fraud or abuse where the hold periods are substantially shorter than they are in States where they're that much longer? Some have gone 10 or 12 days. Is it making that much difference is what I'm getting at, based on any data that you have?

Mr. **Angell**. I would point out that the States that do have such legislation probably are more apt to have a lower percentage of the people living in the State that have accounts and there is a kind of a tradeoff.

And you're correct, that if information doesn't get back as fast as the schedule permits, that's an invitation to kiting and fraud. So we've got to speed the process up. Now if there's an invitation to kiting and fraud, then the banks will react to that if they have schedules that can't be met insofar as receipt of the return item—

they will react to that by not permitting the individuals to open an account.

Senator DODD. So you agree that the shorter period actually minimizes the likelihood of fraud?

Mr. ANGELL. The shorter period——

Senator DODD. The shorter the period, the more expedited the process?

Mr. ANGELL. The shorter period we can get the information back, the less chances of fraud, absolutely. But the shorter the period on the schedule, the more likely we are to run into fraud. But we do not have statistical evidence that would indicate an increase in fraud in States that have implemented a law in regard to return items.

Senator DODD. Has any request been made of the States for information in this regard? I'm sure they're looking at it. Have any requests been made of these States which have abbreviated their hold periods to determine whether or not—to examine the fraud questions where the period has been abbreviated? Has the Fed made any requests for such information?

Mr. ANGELL. Oh, yes, and we are looking at that and we have Federal Reserve Banks in each of these areas that are monitoring. I would point out to you that most of those States do have somewhat flexible and ample clearing times for interstate clearance and many of those States do not have the inter-Federal Reserve territory problems that I referred to, for example, in New Mexico.

Senator DODD. Thank you very much.

We've been joined by our colleague from Rhode Island, Senator Chafee. Senator, do you have questions or an opening statement?

Senator CHAFEE. Thank you, Mr. Chairman. Are you through with your questioning?

Senator DODD. I am and we will come back to Senator Shelby in a minute.

Senator Chafee.

STATEMENT BY SENATOR JOHN H. CHAFEE

Senator CHAFEE. Mr. Chairman, I am pleased that the subcommittee will have the opportunity today to examine the issue of check holds. I conducted the first hearing on this issue back in March 1982 when I chaired the subcommittee. The issue has yet to be resolved, and I am hopeful it will receive early action during this session of Congress.

The practice by many financial institutions of imposing holds on customer check deposits has led to considerable inconvenience for many consumers. There are legitimate reasons for placing holds on check deposits. An institution might understandably want to hold a check until it has itself received cash for the funds, or to protect itself against the risk of loss. But I am concerned about those institutions which consistently deny customers the use of funds far beyond the time it takes for the bank to receive credit for the check, and without regard to the size of the check or other factors that would indicate there was little risk.

Surveys continue to show that the practice of holding checks remains widespread by financial institutions. Most of us at one time or another have experienced the frustration of depositing a check and then writing other checks to pay bills, only to learn that the checks are returned as unpayable due to insufficient funds because the check we deposited has not cleared. Long check hold periods are especially troublesome for low-income consumers who frequently depend upon prompt access to the funds they receive just to meet day-to-day living expenses.

Customers also incur monetary losses as a result of check holds, both in overdraft charges imposed by banks and fees imposed by merchants for late payment of bills.

A number of States, including Rhode Island, have enacted laws in the past few years calling for expedited availability schedules and disclosure of bank hold policies. To the best of my knowledge there have been few if any reports from these States that problems have resulted from these shorter hold periods. However, more action—action at the Federal level—appears to be needed in order to assure that banks and Federal regulators are acting to eliminate unnecessary delays on check deposits, especially Social Security and other Government checks.

If new regulations by the Federal Reserve System and other agencies, or legislation by Congress, are not needed to correct the problem, then I believe the burden lies with the industries and regulators to show why. I look forward to hearing from the witnesses joining us this morning.

Thank you.

Senator Dodd. Thank you Senator.

Senator Chafee. Mr. Angell, there's one point you made in answer to Senator Dodd's question. You said that in these States with the short times the fraud is no greater, but did you also say they refused to accept new accounts of, what, dubious characters?

Mr. Angell. For example, in the State of New York, you would tend to have more business being done with currency as comparison to check as you might find in States such as Kansas. I mean, in Kansas most of the transactions would be done by check. You would have a smaller proportion of transactions done with currency.

So you would tend to find in some of the Western States that a larger percentage of the transactions are done by check than you might find in some of the Eastern States where you might use more currency. In addition, there may be some movement where you have had consumer legislation that makes it less desirable for the banks in those States to seek out everybody as a customer, whereas in the Midwest, typically most banks, not being in a high-growth area, might seek out new customers quite readily. You might not have that quite as much in States such as Rhode Island.

Senator Dodd. I don't know.

Senator Chafee. Well, I don't know.

Mr. Angell. Maybe that's a bad example.

Senator Dodd. You're thinking of Vermont and New Hampshire I think.

Senator Chafee. Well, you pick up any newspaper and they're all battling for accounts.

Senator Dodd. And television ads.

Mr. Angell. We hope so.

Senator **Chafee**. Obviously, we don't want to have one of the backlashes from this legislation is to have the banks become more selective, as it were, because of the penalties possible under this legislation and so they become, if you want to call it, restrictive as to who can open an account. That's a downside. But you're suggesting that might be true?

Mr. **Angell**. No. I'm suggesting that if you permit us the flexibility to accomplish the purposes of the act and provide us with the needed authority, we can develop a system that will be more efficient, provide faster availability, and lessen the chances of banks wanting to close out existing accounts or not to open new accounts.

Senator **Chafee**. I see. OK. Fine. Thank you.

Thank you, Mr. Chairman.

Senator **Dodd**. Thank you.

Dick, do you have any more questions?

Senator **Shelby**. Yes. Let's get into the possibilities of fraud that you mentioned there. How would the Fed deal with that under the legislation? For example, there's some possibility of some check kiting here between banks and everything. Would you need more regulatory powers here?

CHECK KITING

Mr. **Angell**. No, I don't think we need more regulatory powers. It is currently, Senator Shelby, against the law for an individual to write a check with intent to defraud if there are not funds in the account.

Senator **Shelby**. Some people forget that, though.

Mr. **Angell**. When people cheat it makes the banking system vulnerable and, consequently, the banks, in defense, delay availability. It is important to educate the American consumer and American business to recognize that when the Congress passes a law there's a reason.

Senator **Shelby**. But that's oftentimes hard to do.

Mr. **Angell**. That is hard to do.

Senator **Shelby**. To disseminate the information.

Mr. **Angell**. It's hard to do when there's economic incentives—when interest rates rose to double digit rates we increased the economic incentive for people to write checks before they got their funds. I understand there were even some cases of securities houses that did such things.

Senator **Shelby**. What about the 4-day rule on this? How would that play in a check-writing scheme?

Mr. **Angell**. Oh, the 4-day rule is going to work just fine in most of the cases, probably 95 percent of the cases.

Senator **Shelby**. Let's talk about those other cases then.

Mr. **Angell**. If you adopt a 4-intervening business days rule we're going to need to have some exceptions in order not to have someone know that they can have an account in Maine and an account in Idaho——

Senator **Shelby**. It was Montana a minute ago.

Mr. **Angell**. Yes. Well, that's all right. I wanted to be kind to everybody.

Senator SHELBY. But that's what you're talking about that you need flexibility?

Mr. ANGELL. Yes. If a depositor is in Idaho and knows they've got 6 days before the check is going to get back and they know the law says you've got to give me credit in 4 days——

Senator SHELBY. And they also know there's money there to cover it, right?

Mr. ANGELL. That's right. If they can do that, then they've got an economic incentive to kite and, Senator, my experience in banking has been that any time we find a business or an individual that has more than one bank account, and if that business or individual gets into severe financial difficulty, kiting will be a temptation. It occurs somewhat more frequently than we can demonstrate and prove and, of course, it poses grave risks to the banks that are out there.

Senator SHELBY. And also grave risks to the people who are doing it if they're caught, right?

Mr. ANGELL. A grave risk. And we hope that people understand what would happen to them if they were caught and convicted.

Senator SHELBY. Thank you, Mr. Chairman.

Senator DODD. Thank you, Governor, for your testimony this morning. Other members of the committee may have some additional questions which we will submit to you in writing.

Again, let me conclude where I began, I thank you personally for your very constructive testimony and your words of support of the general thrust of what we're engaged in here and your very constructive suggestions as well as to how we might improve this legislation even further. So we thank you very much for your time here this morning.

Mr. ANGELL. Thank you very much, Senator Dodd, for hearing my testimony and I would say in closing that your staff is free, of course, to contact our staff and our staff will be available on a high priority basis to answer any questions and work in any way to get the legislation that will be most constructive for the American people.

Senator DODD. Thank you very, very much.

Our next panel of witnesses will include the following five witnesses: Alan Fox, who is the legislative representative of the Consumer Federation of America; Michelle Meier, legislative counsel for the Consumers Union; Franci Livingston is a staff attorney for Congress Watch; Samuel Cooper, who is the representative from the U.S. Public Interest Research Group; and Gayle Lawrence, who is representing the American Association of Retired Persons.

I thank all of you for being here this morning to comment on this legislation. Let me tell you at the outset we will take all of your testimony and include it in the record. Some of it, having read over it, is very comprehensive testimony and goes into great specificity about either technical suggestions or substantive suggestions in the legislation—very worthwhile and very helpful. Obviously, given our time constraints, we can't listen to all of that testimony, but I would appreciate it very much if you could paraphrase your remarks.

In terms of the batting order here, is there any problem beginning with Mr. Lawrence and then going to Mr. Cooper and then we'll hear from Congress Watch, Consumers Union and the Consumer Federation of America in that order, if that's acceptable to all of us. Again, we appreciate you being here.

Mr. Lawrence, we're delighted to see your testimony.

STATEMENT OF GAYLE K. LAWRENCE, ON BEHALF OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. LAWRENCE. Thank you, Senators Dodd and Shelby and members of the subcommittee. My name is Gayle K. Lawrence. I live in Lansdowne, PA, which is in the Philadelphia area. I'm pleased and proud to be here today to represent the views of the American Association of Retired Persons, which you may know is a very large organization of over 24 million members nationally, with some 1½ million of these residents of Pennsylvania.

The matter of which we speak today, check holds, is something about which I feel keenly, quite aside from my representation of AARP. My family and I have suffered the indignities on a few occasions of having checks returned with that horrible marking of insufficient funds based upon deposits which were 1 week old. In a small community, word of that kind gets around in one awful big hurry and does nothing to help one's credit rating.

Also, I'd like to point out to the subcommittee members that my community of Lansdowne, some 11,000 souls, is no different from thousands of other similar communities, small towns of America, in which we have only one commercial bank and you do business on that bank's terms or you simply don't do business at all.

AARP'S VIEWS ON CHECK HOLD

But I'm here today not to speak on behalf of matters of inconvenience or indignity. I want to express the AARP's very strong views with regard to the interests of millions of Americans, especially older Americans who count on their money being available to them on short notice. These are persons who live literally from one Social Security check to the next, on a monthly basis, so that a delay even of the 4 days of which Governor Angell has just spoken is a matter of moment to these people.

I am talking about people who use money for groceries and money to pay utility bills and money to pay their monthly rent and even a delay of a few days is of great consequence to these persons. Many of these persons are persons who would rarely think to write to distinguished Members of the U.S. Senate. They are either fearful of doing so or they don't know how to do it or a combination of both.

I'm talking about persons, also, who are not involved in electronic transfer of funds. We have surveyed our own 24 million membership and found that less than half of them actually have authorized electronic payment of their Social Security money. These are people who like to feel the piece of cardboard in their hands and think that there's an asset that has material value. They want to deposit it with their own hands and they want to get their hands on their own money represented by these checks. Sometimes these are checks representing small pensions.

But we're talking about little people here, not just matters of inconvenience which perhaps even Members of the Senate have suffered at one time or another.

The American Association of Retired Persons knows that this is no local matter. This is a national problem. And I have here in my hands just a sampling of letters and a bundle here which is representative of hundreds of letters which have come to the American Association of Retired Persons directly or in some cases are copies of letters to Senators that have been turned over to us.

It's a national problem and these people—I could read excerpts from their letters—are crying out for Federal legislation. They need it and they want it, gentlemen. The American Association of Retired Persons is eager to see that this legislation, on which Senator Dodd and his colleagues have taken the initiative and leadership in these early days of the 100th Congress, is passed. Thank you for that, Senator, and we congratulate you. We pledge all of our resources to help you in any way you see fit. We are hopeful that we might anticipate early enactment of that legislation.

Senator DODD. I thank you very much, Mr. Lawrence. In fact, with your permission, I would like to be able to take at least a representative selection of those letters that you have received and make them a part of this record if we may.

Mr. LAWRENCE. I'll be glad to provide copies for you, sir.

Senator DODD. Thank you very much.

[The complete statement of the consumer groups and a representative selection of letters from the AARP follow:]

TESTIMONY OF

AMERICAN ASSOCIATION OF RETIRED PERSONS

CONSUMER FEDERATION OF AMERICA

CONSUMERS UNION

PUBLIC CITIZEN'S CONGRESS WATCH

and

U. S. PUBLIC INTEREST RESEARCH GROUP

before the

SUBCOMMITTEE ON CONSUMER AFFAIRS

of the

SENATE COMMITTEE ON BANKING,

HOUSING AND URBAN AFFAIRS

February 5, 1987

INTRODUCTION

Mr. Chairman and Members of the Consumer Affairs Subcommittee:

The American Association of Retired Persons[1], Consumer Federation of America[2], Consumers Union[3], Public Citizen's Congress Watch[4], and the United States Public Interest Research Group[5] appreciate the opportunity to testify today.

We commend you, Mr. Chairman, for your leadership on the check hold issue over the course of three Congresses, and in particular, for the check hold bill you have introduced this session. We are eager to work with you to ensure that your efforts come to fruition this session in the form of a strong check hold law.

The resolution of the longstanding check hold issue is one of our highest priorities for early action in this session of Congress. The check hold problem is not new to either the Senate or the House. Both houses of Congress have held comprehensive hearings on the check hold issue, beginning with Senate hearings in 1982.

We believe the check hold issue is ripe for swift action. We urge this Subcommittee to make sure that check hold legislation is part of the first piece of banking legislation this session, so that consumers can finally obtain long-awaited relief from holds practices.

THE PROBLEM

The extent of the delayed funds problem has been documented by consumer groups. A 1986 nationwide survey of 458 banks and savings and loans conducted by the U.S. Public Interest Research Group[6] showed that a majority of the institutions surveyed hold local checks for 3 to 5 business days. 76 percent said they hold out-of-state checks for six business days or more, and 20% said that they hold these checks more than 2 weeks. The 1986 survey showed no improvement in the holds problem since an earlier study conducted by U.S. PIRG in 1985[7].

Even cashier's and government checks are not exempt from long holds. 37 percent of the institutions in the U.S. PIRG study said they hold out-of-state cashier's checks for over a week and 8 percent hold these checks over two weeks. 17 percent say they hold government checks over three business days. A survey of 31 banks and savings and loans conducted by Public Citizen in 1985[8] found that 25 percent of Washington D.C. area institutions place holds on U.S. Government checks. Half said they hold payroll checks.

Federal Reserve Board surveys, conducted in 1977, 1981, 1983, and 1985, revealed that 14%, 25%, 13%, and 15% respectively of people with checking accounts have had delayed availability problems. These Federal Reserve figures yield an estimate of between 6.5 to 12 million consumers who have experienced problems when denied access to their funds. It is particularly disturbing that the Federal Reserve figures rose between 1983 and 1985 despite increased pressure on depository institutions to improve holds policies by both Congress and the public.

Long hold periods are a source of irritation, inconvenience and monetary loss for consumers. The most obvious hardship is the chronic delay in gaining access to needed funds. The whole purpose of depositing funds in a checking account is to have ready use of the money.

The hardship presented by lengthy hold periods hits low and moderate income consumers the hardest. Figures presented by the Federal Reserve Board show that 40% of all families have less than $1000 in financial assets. Many of these people live from paycheck to paycheck and frequently need immediate access to at least a portion of whatever funds they receive to meet daily living expenses.

In addition to creating access problems, holds create monetary costs for consumers. Banks may impose high overdraft charges when checks are written on "held" funds. The Federal Reserve reports that 9.72 million checks were returned in 1981 due to holds imposed on deposited funds.[9] This means, based on an average bounced check fee of $14,10 that consumers pay $135 million a year in overdraft charges alone due to holds.

It is impossible to estimate the additional costs to consumers because of check holds. For example, we do not know how much interest is lost from interest-bearing accounts, nor how much consumers lose to late fees assessed by merchants and creditors because checks they write in good faith bounce when banks impose holds on their deposits.

THE CHECK CLEARING PROCESS

The check clearing process is complex in practice but simple in theory. A deposited check is quickly forwarded from the bank of deposit to a clearinghouse, either a branch of the Federal Reserve or a large commercial bank. The clearinghouse sorts the checks it receives and routes them to the payor bank, (the depository institution on which the check is drawn).

The clearinghouse, in addition to routing the check to the payor bank, credits the account of the bank of deposit for the amount of the check. Upon receipt of the credit, the bank of deposit can immediately invest the funds even though these funds are withheld from the depositor. The Federal Reserve estimates that banks receive over $290 million a year because of this ability to take advantage of the float.[11] A law review article on the subject notes that one extra day of float for the banking system has been variously estimated to produce $800 million to $1 billion a year in revenue for the banking industry.[12]

The timing for when the bank of deposit receives credit is based on availability schedules. These schedules reflect how long it takes, on average, for a check to travel to the payor bank for payment. The Federal Reserve reports that 99% of checks clear (the bank gets credit for the funds) in 1 or 2 business days. The rest clear in 3 days.

The Federal Reserve Bank of Richmond/Baltimore Branch availability schedule, for example, does not show a delay greater than 2 days regardless of whether the check is traveling to Philadelphia or Los Angeles. Consequently, in no case represented by the schedule would more than 2 days elapse before a bank had, and could use the funds deposited by check.

In the vast majority of cases, the check is good and the payor bank pays the funds to the clearinghouse. The process is then complete. Banks do not receive notice that a check is good, nor do they wait for the funds to be paid, because they have already been credited by the clearinghouse.

If a check is bad, the payor bank does not typically notify the bank of deposit directly but rather returns the check by the same route as it was forwarded, to the clearinghouse and then to the bank of deposit. A bank of deposit must return the funds advanced by the clearinghouse if a check returns unpaid, though actual losses because of bad checks are miminal.

Because so few checks are returned, the return process, unlike the forward process, has not been automated. The forwarding process is extremely sophisticated and makes use of magnetic imprints on checks, high speed processing machines, jets and overnight couriers so that banks can get credit and use of the depositors' money very quickly.

The return process relies on a manual sorting process rather than high speed automation. Moreover, the check retraces its forward path and consequently is returned through one or more clearinghouses before finally arriving at the bank of deposit. Each institution involved in the return of the check may delay until midnight of the day following the date of receipt of the check to start the return process, and, even then, it often simply places the returned check in the regular U.S. mail.

In most cases, the bank of deposit does not learn whether a check has been dishonored until enough time has passed to allow for the check to reach the payor institution and make its long way back. However, even after waiting 15 days, for example, for a check to return, the bank of deposit cannot be sure the check has been honored because the current system imposes an obligation to notify only in the case of dishonor. A mishap in the forwarding or return process can extremely delay receipt of that notice by the bank of deposit.

A HISTORY OF INACTION BY THE REGULATORS AND THE INDUSTRY

The delayed funds availability problem has long been recognized. The Federal Reserve Board has studied delayed funds since 1977, the year the Board first conducted a consumer survey on holds. In February 1979, a joint task force of the American Bankers Association and the Federal Reserve Board found that "delayed funds availability is a widely employed and common banking practice," and recommended that banks make funds available to established, financially responsible customers on a schedule at least equal to the receipt of credit by the bank of deposit.13 Five years later, in 1984, the federal regulators issued a joint, non-binding policy statement encouraging institutions that delay availability "to review and disclose their policies, and to refrain from imposing unnecessary delays on all checks, particularly on Social Security and other government checks."

Yet despite continued public outrage and Congressional prodding, neither voluntary efforts nor action by the federal regulators have provided relief for consumers. The studies conducted by the U.S. Public Interest Research Group in 1985 and 1986 document that lengthy holds continue to persist nationwide. In addition, as previously noted, Federal Reserve surveys show that the numbers of consumers reporting delayed funds problems increased between 1983 and 1985. Former Vice Chairman of the Federal Reserve Board, Preston Martin, commented on this increase in hearings before the House Banking Committee:

> The survey did not show any significant decline in the percentage of families reporting problems. In fact, the 1985 survey showed a slight increase in the percentage of families reporting delayed availability problems compared to the 1983 survey which we did. So we are not very positive with regard to the reports so far on the 1984 joint statement and the reviews that we have done on a voluntary basis.14

Under the pressure of legislation proposed in the 99th Congress, the banking industry came up with a new response. Now they claim that the check hold problem does not exist. In the past year, several "studies" of self-selected samples of depository institutions have claimed that only a minuscule proportion of checks are subject to holds.

Sampling and bias problems aside, these surveys fail to distinguish between deposits into consumer accounts and deposits into business accounts. Most checks are deposited not by individual consumers but by businesses, and business accounts are generally not subject to holds. Consequently, the study reflects a large number of checks that are irrelevant to this consumer problem.

STATE LEGISLATION

Frustrated by the lack of improvement in check hold practices, states have begun to pass legislation. Eight states have adopted mandatory availability schedules: California, Connecticut, Illinois, Missouri, Massachusetts, New York, Rhode Island, and Wisconsin.

State legislation has not, however, been able to provide a solution to the check hold problem. The Federal Home Loan Bank Board issued an opinion on March 7, 1984 that the New York state funds availablity law does not apply to federally-chartered savings and loans because of the preemption doctrine. A similar position was taken by the National Credit Union Administration in a regulation issued by that agency on February 1, 1985.

THE SOLUTION

We firmly believe that federal legislation is the only way to resolve the check hold problem. The general scheme for legislation should be to require banks to make funds available on a schedule that reflects the period required for the bank to receive credit for the category of check deposited, i.e., within 1-3 days after desposit. Specific exceptions should be provided from the mandated hold periods for situations that involve potential risk to the bank.

Some members of the banking industry argue that legislated reductions in hold periods should not occur until the check clearing system has been improved. A bank should not release deposited funds, this argument goes, until enough time has elapsed for it to be confident that the check has been honored by the bank on which it was drawn.

However, there is no need to delay implementation of a holds schedule that is based on receipt of credit by the bank of deposit. This is because the present use of long holds does little toward protecting a bank against loss that could not be achieved by allowing banks to impose such holds only in potentially high risk circumstances.

Long hold periods are based on crude estimates of the time it takes for any category of check to be presented to the payor bank and returned to the bank of deposit. However, these estimates do not protect a bank when a customer intentionally writes or deposits a bad check. Someone who wishes to defraud a bank by receiving cash for a check written on insufficient funds can do so now by tampering with the check's magnetic strip, which is used to make the check machine readable for sorting purposes during the forwarding process. This delays the check in its forward movement toward the payor institution, requiring the processing banks to handle the check by hand. Even the longest hold periods could be ineffective against this kind of scheme.

In spite of long holds, the present clearing process also leaves a bank vulnerable to losses on checks with forged signatures. Because of the large volume of checks, a payor bank does not usually have the time or resources to determine whether signatures are valid. At most, the payor bank is able only to check to make sure that endorsements and signatures are actually present. By the time a forged signature is discovered, which is likely to be at the time the customer reviews his monthly statement, even a lengthy hold period has already passed.

In fact, holds are not effective protection to banks against losses in many instances because dishonored checks arrive at the bank of deposit long after a hold period has expired. A three week survey of return items by a New York savings institution and summarized by the United States League of Savings Institutions in the 1983 Senate hearings showed that the forward and return process "almost always exceeded the hold period and usually by a significant number of days." The U.S. League notes:

> ...while the association uses the equivalent of a seven day hold for items drawn on institutions in metropolitan New York, only 1% of checks returned by local institutions were received within the seven-day hold period. About 90% took at least 10 days to be returned, 54% took at least 13 days, and 10% took more than 15 days.
>
> The association had a similar experience with items drawn on institutions outside the metropolitan area. For these items, the association uses the equivalent of an 11 calendar-day hold. About 10% of these return items were received within 11 calendar days. About 60%, however, required at least 16 days to be returned and 10% took at least 20 days to be received.[15]

Moreover, the current level of losses is small and should not increase significantly under legislated hold periods because most consumers simply do not want to write bad checks and would "make good" on a bad check if they wrote one. The Federal Reserve Reports that 99 percent of all checks are paid the first time through the collection process.[16] More than 60 percent of returned checks are for less than $100 and approximately half of all returned checks are paid the second time through the collection process. Most returned checks do not result in losses because the bank usually recovers from the depositor.[17] In the end, only one in 5,245 returned checks actually results in loss to the bank.[18]

The type of scheme we endorse has precedent both in law and industry practice. Massachusetts law, for example, requires two day availability for checks drawn on any bank in the entire New England area and four day availabity on checks from outside the region. The law allows exceptions in specific circumstances that involve potential risk, including exceptions for new account holders, for amounts over $2500, for account holders that have repeated overdrafts and for checks that raise a good faith doubt of collectability. The law, which is not premised on any improvements in check processing technology, has been very successful. The Office of the Massachusetts Commissioner of Banks reports that there have been no problems due to increased losses as a result of the check clearing law.

In addition, some banks already have hold practices that are as short or shorter than what we urge. In testimony before the Banking Committee in 1983, Bank of America stated that it places holds, only on an exception basis, on less than 1% of the checks it receives. These holds are imposed only on a case-by-case basis depending on the risk of loss presented by a particular check. The 1986 study by the U.S. Public Interest Research Group, in addition to finding a high percentage of lengthy holds, also documented that 22 percent of the banks grant immediate access to local checks and 9 percent grant immediate access to out-of-state checks. Even the ABA-Federal Reserve Task Force that studied delayed funds availability in the seventies issued a report indicating the workability of this scheme. It stated that banks should "retain the flexibility to provide established, financially responsible customers with funds availability on a schedule at least equal to the receipt of 'provisional credit' by the bank without extending similar funds availability in situations that may involve crime or financially irresponsible individuals."

THE DODD BILL

We support many aspects of S.344, but we believe improvements must be made for the bill to provide needed benefits for consumers. Some of these improvements are technical in nature, while others concern the timing and content of the availability schedules.

The Dodd bill requires the Federal Reserve Board to promulgate a delayed funds regulation within four years after enactment. In promulgating the regulation the Board can choose one of two options.

One option is to improve the system for returning checks so that a depository institution would reasonably be expected to learn of a dishonor within the time periods established by the availability schedule. Under this option, the regulation would allow up to four intervening days between the day of deposit and the day of availability. This outside day limit could be extended to five intervening days by the Board if the extension is necessary for banks to reasonably expect to learn of dishonor under an improved return system. In either case, the Board would base the schedule on the forward and return times for particular categories of checks. This option provides three exceptions to the mandated availability schedule: for checks where the bank of deposit has a reasonable suspicion to believe that the check is uncollectable; for emergency situations such as suspension of payments by another depository institution; and in cases where the Federal Reserve temporarily suspends the availability schedule due to fraud losses for a particular class of checks.

Option two requires the Federal Reserve to issue an availability regulation without improving the return system. This regulation would allow no more than four intervening days between the day of deposit and the day of availability. The Board would tier the schedule based on the time needed for the bank of deposit to receive credit for the check, considering geographic location, the type of institution involved, and type of intrument.

Option two would allow the Board to promulgate additional exceptions to the availability schedule including exceptions for new account holders, large dollar amounts, deposit accounts that have been overdrawn repeatedly, checks that have been returned unpaid and redeposited, and any other class of checks where the Board finds, based on substantial evidence, that such class poses a serious risk of loss to depository institutions. In addition, the three exceptions from option one would apply to this option as well. This option contains more exceptions than option one because it relies on the exceptions, rather than improvements in the check processing system, to protect depository institutions from potential risk.

RECOMMENDATIONS

1. TIMING. The availability schedules in the bill are not required to become effective for another four years. This is true even for the special schedule for government checks under Section 6.

The schedule that we have referred to as option two and the government check schedule should become effective very quickly instead of four years after enactment. Option two is workable today without improvements in the check processing system because, like Massachusetts law, it relies on exceptions to the holds schedule to protect banks from undue risk. The passage of time has nothing to do with the workability of option two.

Similarly, the protections afforded depository institutions in the government check schedules make that schedule workable today. The government check schedule would apply only to a check endorsed by the person to whom it was issued. Consequently, there would be minimal risk of fraud because the check could only be deposited into the account of the rightful payee.

Short of expeditious implementation of option two, we believe the bill should require a temporary availability schedule that lasts until the final regulation becomes effective. A temporary schedule would provide consumers immediate relief from some of the most eggregious holds practices instead of postponing any protections for another four years. The temporary schedule would also allow the banking system to gradually make the transition into reduced hold periods. The final regulation for availability of government checks should take effect at the same time as the temporary schedule.

2. HOLD PERIODS. (A). We urge an availability schedule of 1-3 intervening days rather than a schedule that allows four or five days to intervene before funds are made available to the account holder. We have discussed the workability of this approach earlier in our testimony. A 1-3 day availability schedule should include next day availability for special classes of checks such as cashier's checks. These checks present minimal risk of loss because they are drawn by a bank on the bank's own funds. Given the historic disinterest of the Federal Reserve Board toward resolving the check hold problem, we are reluctant to rely on their discretion to establish the details of this availability schedule.

(B). We are very concerned about the day limits for hold periods under option one. Section 5(b)(1) allows the Board to issue a regulation for improving the check processing system so that depository institutions can reasonably be expected to learn of the nonpayment of a check in the "time periods" set forth in Section 5(b)(3). This latter section contains only two time periods. It requires that the funds availability regulation issued by the Board shall provide that no more than four or five intervening days shall pass between the day of deposit and the day of availability and that the regulation shall differentiate time periods based on provisional credit plus return times. In sum, these two subparagraphs provide for the Board to 1) improve the check processing system such that depository institutions can expect to learn that a check was dishonored within four or five intervening days and 2) to issue an availability schedule, containing no period in excess of four or five intervening days, that differentiates time periods based on provisional credit plus return times.

Our concern is that, under the language of Section 5(b), the Federal Reserve Board could find that most in-state checks, for example, are already returned in four or five intervening days under the present check clearing system. They could then decide to focus only on out-of-state items in improving the check clearing system. The result would be a schedule in which all checks, including in-state checks, would be required to be available only after four or five intervening days. This result would subvert the purpose of the legislation. The holds permitted for in-state checks would be far longer than they would have been had the Board proceeded under option two and promulgated an availability schedule that did not require any improvements in check processing technology but instead relied on exceptions from the mandated hold periods. Lengthy and unnecessary holds on in-state checks would be sanctioned.

We are eager to work with you and your staff to draft language that solves this problem.

3. REASONABLE SUSPICION EXCEPTION. Both options one and two allow depository institutions to invoke an exception to the mandated availability schedule when they have "reasonable suspicion to believe that funds for the check...are uncollectable." This type of exception poses obvious concerns because depository institutions could unilaterally negate the law based upon subjective suspicions. If depository institutions are to be accorded this discretion, it should be clarified that the exemption may be invoked only on the basis of objective facts indicative of fraud, not suspicion.

We are pleased that the account holder must be given notice when the "reasonable suspicion" exception is invoked. This notifies the account holder that the normal holds schedule will not apply to his particular check and also can act as a deterrant against misuse of the exception. The use of the "reasonable suspicion" exception should be further monitored by requiring depository institutions to retain records of notice provided under the exception for review by the federal regulators during the regular examination process.

Our final recommendation concerning the "reasonable suspicion" exception is that the exception should not apply if the Federal Reserve Board chooses to proceed under option one.

Option two provides for the Board to promulgate an availability regulation that relies on exceptions for potentially high risk circumstances. By contrast, option one allows for improvements in the check processing system such that an institution could reasonably expect to learn that a check had been dishonored by the time the permissable hold period expired. Option one, therefore, does not need exceptions from the holds schedule to protect depository institutions because it is premised on actual notice of dishonor within the holds periods. The whole purpose of making the investment necessary to improve the check processing system is to allow the availability schedule to apply to all checks without exceptions.

4. THE EXCEPTIONS. Among the exceptions allowed under option two are an exceptions for new account holders and for large dollar amounts. These exceptions should be defined by statute rather than Federal Reserve Board regulation, especially given the disinterest the Board has shown toward check hold problem. Both are exceptions that are of particluar importance to consumers in terms of the overall benefit of the law. We believe a holds bill should set the new account holders exception at 30 days and the large dollar amount exception at $5000. Four of the state laws have a 30 day new account holder exception, and in addition, Connecticut only extends the exception to the opening deposit for a new account. Missouri sets the large dollar exception at $5000 and Illinois, Wisconsin and Connecticut have no such exception at all.

5. NEW ACCOUNT HOLDERS. One class of persons that

consistently has serious holds problems are new account holders. Even though we support a new account holder exception, we also believe that a holds bill must provide access to some funds for these persons, at least through cashier's checks.

Lengthy holds on cashier's checks are particularly unfair because these checks are drawn by a bank on the bank's own funds. Moreover, the consumer typically pays for a cashier's check based on the expectation that the check will be treated as cash. This reasonable expectation should be fulfilled by applying the bill's mandated availability schedules to cashier's checks deposited in new accounts.

TECHNICAL RECOMMENDATIONS

1. CONTINUING AUTHORITY. Under the bill, the Federal Reserve Board has four years to proceed under either option one or two. We have already urged the Committee to make option two effective almost immediately, since that availabity schedule relies on exceptions rather than improvements in the check processing system. We also believe that once option two takes effect, even if that date is four years after enactment, the Board should have continuing authority to improve the check processing system at any time under option one. As the bill is presently written, the Board could proceed under option two and loose the authority to improve the check clearing system because it had not proceeded under option one within the four year time frame. This continuing authority would obviously apply only after option two is already in place and could not be used to postpone a final availability schedule.

2. OPTION ONE LANGUAGE. Option one directs the Federal Reserve Board to differentiate the availability schedule based on "provisional credit plus return times." The method chosen by the Board to improve the clearing process may take a form other than return of the physical check on an expedited basis, however. For example, the Board may instead require direct notification that a check has been dishonored. In that case, the check could actually return long after direct notification of dishonor had been received. The availablity schedule, under a system of direct notification, should reflect the time necessary to receive notice rather than the longer time needed for actual return of the check. Consequently, the language requiring the Board to differentiate permissible hold periods under option one should be changed from "provisional credit plus return time" to "time necessary for depository institutions to reasonably expect to learn of the nonpayment of any item." This new language would reflect the fact that the Board could choose one of several methods, not simply expedited check return, to improve the clearing process.

3. INTEREST ACCRUAL. Under Section 4, the bill provides that a depository institution may not delay interest accrual on a checking account beyond the date that it receives provisional credit for a check, or if provisional credit is given on a non-

business day, on the next business day. The language allowing additional delay for interest accrual when provisional credit is given on a non-business day should be deleted. We agree that, for funds availability purposes, a deposit made on a non-business day can be deemed to have been made on the next business day because depository institutions do not routinely process checks on non-business days. However, interest accrues on both non-business and business days and consequently accrual should not be delayed beyond receipt of provisional credit.

4. DISCLOSURE. Section 3 of the bill requires depository institutions to disclose their specific check hold policy to new account holders and to existing account holders unless these existing account holders were provided notice of the specific policy previous to the effective date of the section. We believe the bill should also require that the specific check hold policy be made available to any person upon request. This type of provision would greatly assist consumers who are shopping for new accounts as well as existing account holders who received specific notice years before the effective date of the section.

Section 3(d) provides that depository institutions must notify customers of changes in their funds availability policies unless the change expedites the availability of funds. We urge that notice should instead be provided for all significant changes, including those changes that expedite availability.

The disclosure section of the bill takes effect one year after enactment and three years before the availablity schedules are required to become effective. Consequently, under the bill, a depository institution would be required to disclose its present availablity policy but would not be required to notify customers of reduced holds periods once the new schedules in the law take effect. A requirement that depository institutions disclose changes that expedite availability is critical for allowing consumers to benefit from the Act because this disclosure would notify them that they no longer had to wait for a lengthy period before using their funds.

FOOTNOTES

1. The American Association of Retired Persons (AARP) is the nation's largest membership organization, representing the interests of 24.5 million members age 50 and over.

2. Consumer Federation of America is a coalition of over 200 national, state and local consumer, senior citizen, labor, farm, cooperative and rural organizations which together represent over 30 million people.

3. Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information, education and counsel about consumer goods and services and the management of family income. Consumers Unions's income is drived solely form the sale of Consumer Reports, its other publications and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 3.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

4. Public Citizen is an advocacy, lobbying and litigation organization with 80,000 members nationwide. Since its founding by Ralph Nader in 1971, Public Citizen has fought for product safety, a healthy environment and consumer rights in the marketplace.

5. U.S. Public Interest Research Group (U.S. PIRG) is a national nonpartisan, non-profit consumer and environmental organization which serves as the national advocacy offices for members of state PIRGs.

6. "Still Held Up at the Bank: The Second National Study of Check Holds," U.S. Public Interest Research Group. May, 1986.

7. "Held Up at the Bank: A Study of Check Hold Policies Across the Nation," U. S. Public Interest Group. April, 1985.

8. "Checking on Accounts: A Survey of Fees, Charges and Check Holds Imposed by Financial Institutions in the Washington, D.C. Metropolitan Area," Public Citizen. March, 1985.

9. Statement of Preston Martin, Former Vice Chairman of the Federal Reserve Board, Hearings on the Expedited Funds Availability Act before the Subcommittee on Financial Institutions of the House Committee on Banking, Finance and Urban Affairs, 98th Cong., 2d. Sess., April 4, 1984, p. 213.

(Hereinafter referred to as 1984 House Hearings).

10. "Bank Fees on Consumer Accounts," Consumer Federation of America. June, 1986.

11. House Banking Committee Report on The Expedited Funds Availability Act, November 26, 1985. 99th Cong., 1st Sess., Report #99-404. Page 12.

12. Steven Weschler, "Delayed Funds Availability," 35 Syracuse Law Review 1117, 1158 (1984).

13. Delayed Funds Availability Task Force, "Final Report and Recommendations," February, 1979. Page 10.

14. Statement of Preston Martin, Former Vice Chairman of the Federal Reserve Board, Hearings on the Expedited Funds Availability Act before the Subcommittee on Financial Institutions of the House Committee on Banking, Finance and Urban Affairs, 99th Cong., 1st Sess., October 10, 1985. Page 211.

15. Statement of the U.S. League of Savings Institutions, Hearings on the Fair Deposit Availability Act before the Subcommittee on Consumer Affairs of the Senate Banking Committee, September 28, 1983 at 20.

16. 1984 House Hearings at 193.

17. Id.

18. "The Impact of Exception Items on the Check Collection System," Bank Administration Institute, 1974. The report also found that the total estimated loss for banks was only $5 million.

AARP

February 19, 1987

Mr. Edward M. Malan
Senate Committee on Banking, Housing
and Urban Affairs
Room SD 534, Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Malan:

During recent hearings on check holds, Senator Dodd requested a representative sampling of the member mail we received concerning check holds. These are attached for inclusion in the record.

Pursuant to confidentiality concerns, we have deleted the names and addresses of the individuals who responded. However, hometowns and home states remain intact.

Also enclosed please find the transcript of remarks given by Gayle K. Lawrence before the Committee with our corrections.

Sincerely,

WKB
William K. Brunette
Legislative Representative
Federal Affairs

Enclosures

WKB/dk

Morris Plains, N.J.
07950

11338

June 17, 1986

Dear Senator Bradley:

My wife and I are writing for your immediate consideration for legislation, that will limit banks to a one working day hold for government and local checks, and a four working day hold for out of state checks. The current four working days for local and ten working days for out of state is totally unreasonable.

I am retired, and I find it very inconvenient and difficult in managing our money matters.

Senator Bradley, bankers keep telling us this is the age of the computer, then why are they still using the pony express method in the processing of checks?

Your consideration will be greatly appreciated.

Sincerely

Oxnard, CA 93030
11 June 1986

The Honorable Alan Cranston
U. S. Senate
Washington, D. C. 20049

11885

Dear Senator Cranston:

The current practice of many banks in placing a lengthy "hold" period on government, local, and out-of-state checks before crediting funds to accounts is not justified. In this age of electronic transfers between banks, the validity of any check can be quickly determined. A lengthy "hold" is only a means by which the bank deprives the customer of earned interest on his account.

I urge you to request immediate consideration of check hold legislation, restricting banks to a one-day hold for government and local checks. (The government will, I trust, make good on the check.) Four days should constitute a maximum hold for out-of-state checks. Thank you for your time and consideration.

Very truly yours,

[illegible] to Senator [illegible]

NEW HYDE PARK, N.Y. 11040

Tel. (516)352-6771

June 10, 1986

The Honorable Alfonse M. D'Amato
500 Hart Senate Office Building
Washington, D.C. 20501

Re: AARP News Bulletin, Vol.27, No. 6, June 1986

Senator D'Amato:

In the referenced bulletin it was stated that the House of Representatives has passed a check hold limit bill.

I would appreciate immediate consideration by the Senate of check hold legislation. There should be legislation disallowing banks to hold a check for 15 business days when we know that checks clear, via electronic funds transfer, almost immediately. I was recently embarassed when a $2600 check of mine was on a 15 day hold. Not realizing this, I wrote checks against it with the result that several of my checks were returned for "uncollected funds". Fifteen business days translate to twenty (20) calender days!! Incredible! in this modern day of computers. Tabulated below is the policy of the bank with which I deal.

	$100 to $2500	Over $2500
Local checks	3	6 Business days
In-state checks	4	8 Business days
Out-of-sate checks	8	15 Business days

Anything you can do to help resolve this problem would be much appreciated.

Cordially,

NJ

BARNEGAT NEW JERSEY 08005

11878

Dear Senator Bradley:
The House of Representatives has passed a bill which limits banks to a one day hold for government and local checks and a four day hold for out of state checks.

Despite the popularity of this move, the Senate has not acted on approving a similar bill.

[redacted] in our [redacted] to New Jersey when we retired we have often found ourselves in the unenviable position of not being able to draw on funds already deposited in our bank for seven days for personal checks from our out of state mortgagors. Since this is one of the main sources of our income [redacted] to delay in paying our expenses every month. [redacted]. Illness forced my husband to retire at the age of 59 so we can not collect Social Security yet, so we do not have even a government check to deposit which would tide us over . Fortunately this will be forthcoming soon.

As our Senator you have the influence to change our lives for the better. It might seem like a small thing to some, but quicker access to our deposits would enable us to pay our debts in amore timely fashion..won't you consider supporting such a bill in the Senate?

Yours truly.

cc: AARP Depart

[redacted]

RECEIVED
JUN 16 1986
[redacted]RAL AFFAIRS

The Honorable John Heinz, Senator
United States Senate,
Washington D C 20510

11894

Honorable Sir: Ree Check Hold Limit

In the June issue of the AARP News Bulletin there is an article regarding check holding by the banks on out-of-state checks. Banks are routinely holding check for 10 working days- that is two full weeks. They asked us to write our Senator.

This procedure has not bothered me as a Senior Citizen, but [redacted]

Quote from the article "According the Federal Reserve Board 99% of checks are good. The small percentage seldom result in losses because the bank usually recovers from depositors. Banks collect on most checks within two business days."

Since the great buy-out- takeover fever is raging in the United States you never know where your next paycheck is coming from. This is not only frustrating and inconvenient for working people as well as Senior Citizens.

With the electronic equipment the banks have to-day, it should not be necessary to hold the depositors money for two weeks. There c[redacted] of money involved, interest free for the banks. [redacted] there are fees for everything.

I trust you will give this bill your support.

Yours very truly,

Pittsburgh, Pa. 15202

11879 Peggy - I want to use this quote somewhere - Kent

June 16, 1986

Honorable Alan Cranston
U.S. Senate
Washington, D.C. 20520

Dear Senator Cranston:

As a voting member of your constituency, I would like to thank you for your concern for the needs of the retired members of our community. The problems we encounter in taking care of necessary financial transactions also effect the majority of Americans.

I believe that financial institutions should have a fair return on the handling of money and transfer of funds between the originating and concluding parties. However I have also had experience with the inconvenience, if not outright hardship, imposed on the customer when the processing time is excessively prolonged.

[redacted]

It has been brought to my attention that no less an authority than the Federal Reserve Board states, "99% of checks are good. Banks collect on most checks within two business days." Yet banks routinely hold checks, some for ten days or more. It seems to me that it should be of concern to our elected officials that firm limits be set on these institutions.

I know that you, as well as other lawmakers, have to weigh the issues and that you represent not only the "people" but also the needs of business interests. My concern is that sometimes the business interests seem to carry more clout, due to money contributions for campaign costs, than do the legitimate needs of the individual.

I would therefore urge members of the Senate to follow the House of Representatives in the matter of passing a bill limiting banks to a one-day hold for government and local checks and a four-day hold for out-of-state checks. This seems reasonable as the bill would also protect bankers from fraud and bankruptcy.

Thank you for your consideration of my request and I would appreciate a response regarding your feelings on this matter.

South San Francisco,
California 94080

C O P Y

Michigan

Grosse Pointe, Michigan 48230

June 11, 1986

11893

The Honorable John Kelly
U.S. Senate
Washington, D.C.

Dear Senator Kelly,

I am requesting your immediate consideration of check hold legislation.

[redacted]

This check hold practice is unreasonable and places an undue hardship on many people. I am widowed, working and on a fixed income.

Thank you,

NJ

BARNEGAT NEW JERSEY 08005

11878

Dear Senator Bradley:
The House of Representatives has passed a bill which limits banks to a one day hold for government and local checks and a four day hold for out of state checks.

Despite the popularity of this move, the Senate has not acted on approving a similar bill.

[redacted] in our [redacted] to New Jersey when we retired [redacted] found ourselves in the unenviable position of not being able to draw on funds already deposited in our bank for seven days for personal checks from our out of state mortgagors. Since this is one of the main sources of our income [redacted] to delay in paying our expenses every month. [redacted] illness forced my husband to retire at the age of 59 so we can not collect Social Security yet, so we do not have even a government check to deposit which would tide us over . Fortunately this will be forthcoming soon.

As our Senator you have the influence to change our lives for the better. It might seem like a small thing to some, but quicker access to our deposits would enable us to pay our debts in amore timely fashion..Won't you consider supporting such a bill in the Senate?

Yours truly,

cc: AARP Departm

[illegible]
June [illegible]

[illegible] 16 1986
[illegible]ERAL AFFAIRS

11901

The Honorable [illegible] Bradley
U.S. Senate
Washington, D.C.

Dear Sir:
The banks practice of holding [illegible] government checks sent for deposit is not only frustrating and inconvenient but is [illegible] costly as well. There [illegible] utility [illegible] one utility charge [illegible] dollars per month [illegible] this amount [illegible] charges in a five week month [illegible] placing two charges on a single [illegible] check. To keep abreast of this [redacted]mpossible [redacted] [illegible], and causes a [redacted] situation. Sometimes cutting dow[redacted] on necessary food..
Your efforts and support of legislation against such check holding would be greatly appreciated.

NY

11892

Honorable Thomas P. O'Neill
U.S. Senate
Washington,D.C. 20510

June 11, 1986

Dear Sir,

I am writing to you about a bill which is presently before the Senate, which relates to the holding of checks by banks. In many cases I have had to wait an extremely long time after depositing a check before I could draw against the deposit. In one instance, namely the Savings Bank of Rockland County, there is a wait of twenty working days before one can use the deposited funds. [redacted] the fact that the bank gets its money within two or three days, this can only be described as a great windfall for the banks to have the use of a depositors money for twenty days without paying any interest on it--just because it's an out of state check. Also, it is my understanding that the losses due to uncollected checks are rarely truly losses: they are usually made good by the issuer or covered by insurance. [redacted] service fees [redacted]hile at the same time offering fewer and fewer amenities and courtesies.

As my representative in the Senate I am asking you to support a bill now before the Senate which sets a four day limit to the holding of out-of-state checks. Thank you.

Sincerely yours,

---

copy

11884 6-10-86 NY

Dear Senator Moynihan, Horton, D'Amato,

"Please consider check hold legislation by banks. [redacted]

I also would like you to look into the interest charges that stores and Visa accounts are getting. That too, is out of line."

Rochester, NY 14610

11889 Galena RECEIVED
June 1986
FEDERAL AFFAIRS

A.A.R.P.s Dept of Federal Affairs
To Whom it may concern:

As advised in the latest edition of A.A.R.P.s paper, I am sending you a copy of the letter I wrote to my senator. Hopefully it will change matters for the better. Letter as follows.

The Honorable Senator Frank Grass

Dear Sir,

As a senior citizen living on Social Security only I request that senator give immediate consideration to legislation concerning the check "hold" practice of many banks [redacted] to stretch [redacted] to the right with- [redacted] for so many days, [redacted] checking account. Recently I made my rent check out on the 30th day of the month and had more than enough in my checking account to cover it. I deposited my S S check on the 3rd of the following month and the landlord deposited my check for payment several days later and it was returned to his bank for insufficient funds and I received notification of the same from my bank. It is the first time I ever had such a thing happen in all of my years of banking. Also, to me it was very embarrassing. I went to the bank and was told that because I had no savings account they had to put a hold on the check for five working days since it was an out of state check, even though it was Government. I was advised to open a savings account and have $500.00 balance at all times to cover the check and there would be no hold. How can a person on fixed income do such a thing? I've been a widow for 29 years and worked and struggled to make ends meet before retiring. I can't get that kind of money together. Surely something can be done to remedy this. Thank you for your kind consideration.

Very truly yours,

Senator DODD. Samuel Cooper.

STATEMENT OF SAMUEL COOPER, ON BEHALF OF U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. COOPER. Mr. Chairman, Senator Shelby, members of the Consumer Affairs Subcommittee, I am Samuel Cooper, an attorney and legislative representative for United States Public Interest Research Group [PIRG].

U.S. PIRG is a national office with State PIRG's across the country. State PIRG's are nonprofit, consumer advocacy organizations.

We commend you, Mr. Chairman, for your leadership over three Congresses on the check hold issue before this committee. We are eager to work with you to ensure that your efforts come to fruition this session in the form of a strong check hold law.

EXTENT OF THE DELAYED FUNDS PROBLEM

The extent of the delayed funds problem has been well documented by consumer groups. A 1986 nationwide survey of 458 banks and savings and loans conducted by the U.S. Public Interest Research Group showed that a majority of institutions surveyed hold local checks for 3 to 5 business days. And 76 percent said that they hold out-of-State checks for 6 business days or more, and 20 percent said that they hold these checks more than 2 weeks. The 1986 survey showed no improvement in the holds problem since an earlier survey conducted by U.S. PIRG in 1985.

Even cashier's and Government checks are not exempt from long holds. Now, 37 percent of the institutions in the U.S. PIRG's study said they hold out-of-State cashier's checks for over 1 week, 8 percent hold these checks for over 2 weeks, and 17 percent say they hold Government checks for over 3 business days.

Long hold periods are a source of irritation, inconvenience, and monetary loss for consumers. The most obvious hardship is the chronic delay in gaining access to needed funds. The entire purpose of depositing funds in a checking account is to have ready use and availability of the money. The hardship presented by lengthy hold periods hits low- and moderate-income consumers and the elderly the hardest. Figures presented by the Federal Reserve Board show that 40 percent of all families have less than $1,000 in financial assets. Many of these people live from paycheck to paycheck and frequently need immediate access to at least a portion of whatever funds they receive to meet daily living expenses.

$135 MILLION ANNUALLY IN OVERDRAFT CHARGES

In addition to creating access problems, holds create monetary costs for consumers. Banks may impose high overdraft charges when checks are written on held funds. This means, based on the average bounced check fee of $14.10, that consumers pay over $135 million annually in overdraft charges alone due to holds. It is impossible to estimate the additional cost to consumers because of check holds.

For example, we do not know how much interest is lost from interest-bearing accounts, nor how much consumers lose to late fees assessed by merchants and creditors because checks they write in good faith bounce when banks impose holds on their deposits.

For the vast majority of consumers, relief can only be expected when the U.S. Congress passes national legislation providing protective ceilings on hold practices.

Thank you.

[The complete prepared statement of Samuel Cooper follows:]

Senator DODD. Thank you, Mr. Cooper.
Franci Livingston.

STATEMENT OF FRANCI LIVINGSTON, STAFF ATTORNEY, CONGRESS WATCH

Ms. LIVINGSTON. Thank you, Mr. Chairman.

I am Franci Livingston, a staff attorney at Congress Watch. I would like to commend you, Mr. Chairman, for holding these hearings and for your continued leadership on the check hold problem.

As you well know, voluntary efforts by the industry and the regulators over the past decade have not curbed unfair holds practices. The Federal Reserve Board has studied the delayed funds problem since 1977, the year the Board first conducted a consumer survey on holds.

In February 1979, a joint task force of the American Bankers Association and the Federal Reserve Board found that delayed funds availability is a widely employed and common banking practice and recommended that banks make funds available to established financially responsible customers on a schedule at least equal to the receipt of credit by the bank of deposit.

LACK OF RESPONSE IS OUTRAGEOUS

Five years later, in 1984, the Federal regulators issued a joint nonbinding policy statement encouraging institutions that delayed availability to review and disclose their policies and to refrain from imposing unnecessary delays on all checks, particularly on Social Security and other Government checks.

Yet despite continued public outrage and congressional prodding, these efforts have not provided relief for consumers. In fact, Federal Reserve surveys show that the percentage of consumers reporting delayed funds problems increased between 1983 and 1985.

Our groups strongly believe that Federal legislation is the only way to stop the unjustified holds placed on consumer funds deposited by check. The basic proposal for legislation should be to require banks to make funds available on a schedule that reflects the period required for the bank to receive credit for the type of check deposited. This schedule would mean that customers would get access to their funds when the bank does, within 1 to 3 days after deposit.

To protect banks in situations involving potential risk, the schedule should have exceptions from the mandated schedule. These exceptions would include, for example, an exception for new account holders, an exception for large dollar amounts, and an exception for accounts that have repeated overdrafts.

This availability schedule properly focuses on the fact that the vast majority, 99 percent, of checks are good, but provides exceptions for those instances where a bank may be at risk.

The type of legislation we endorse has precedent both in law and in industry practice. Some banks already have hold practices that are as short or shorter than what we urge. In testimony before the Banking Committee in 1983, Bank of America stated that it places holds only on an exception basis on less than 1 percent of the checks it receives. These holds are imposed only on a case-by-case basis depending on the risk of loss presented by a particular check.

The 1986 study by the U.S. Public Interest Research Group, in addition to finding a high percentage of lengthy holds, also documented that 22 percent of the banks grant immediate access to local checks and 9 percent grant immediate access to out-of-State checks.

Even the ABA-Federal Reserve task force that studied delayed funds availability in the 1970's issued a report indicating the workability of this proposal. It stated that banks should retain the flexibility to provide established, financially responsible customers with funds availability on a schedule at least equal to the receipt of provisional credit by the bank without extending similar funds availability in situations that may involve crime or financially irresponsible individuals.

Finally, Massachusetts law provides a model for the workability of this scheme. That law requires 2-day availability for checks drawn on any bank in the entire New England area and 4-day availability on checks from outside the New England area. Exceptions are allowed in specific circumstances that involve risk, including an exception for new account holders, for amounts over $2,500, for accounts that have repeated overdrafts, and for checks that raise a good faith doubt of collectibility.

The law, which is not premised on any improvements in check processing technology, has been very successful. Last August, the Massachusetts Commissioner of Banks conducted an informal telephone poll to determine if there had been any increased losses by banks as a result of the regulations. The parties in the survey included the Federal Reserve Bank in Boston, major correspondent banks, trade associations, and a sampling of commercial banks. Said Commissioner Bowman of this survey:

> The overall response was favorable. The regulations are considered fair to both consumers and banks. No documentable instance of loss could be attributed to the regulations.

Thank you, Mr. Chairman.

Senator Dodd. Thank you, Ms. Livingston.

Ms. Michelle Meier.

STATEMENT OF MICHELLE MEIER, LEGISLATIVE COUNSEL, CONSUMERS UNION, WASHINGTON, DC

Ms. Meier. Thank you, Mr. Chairman, and thank you for your continuing leadership on this important consumer issue.

I am Michelle Meier, counsel for government affairs, in the Washington office of Consumers Union, the publisher of Consumer Reports magazine.

Contrary to the claims of some, it is simply not realistic to expect an increase in bad check losses if a 1-to-3-day availability schedule, with exceptions allowed in certain circumstances, were put into place immediately. This conclusion is supported in several ways.

SUCCESS OF THE MASSACHUSETTS LAW

First, we have the empirical evidence of the Massachusetts check hold law. That law has been in effect now for almost 2 years, and even the Massachusetts Commissioner of Banks reports that it is a success.

Second, we have the experience of some banks that already operate under a system of providing rapid availability in most circumstances.

Third, we we have the inevitable fact that the pervasive use of long blanket check holds provides ineffective protection against bad check losses anyway. This is because even a lengthy hold period can pass before a bank learns that a particular check is bad. Consequently, to eliminate long blanket holds immediately will not increase bank losses. We have arrived at this last conclusion by studying the check clearing system.

One very important aspect of that system is the fact that a bank only learns a check is bad when it is physically returned to it by the payor bank. That can and frequently does take an exceedingly long period of time, a period of time that exceeds even a lengthy check hold.

This was made clear in a study that was presented before the Senate Banking Committee in 1983 by the U.S. League of Savings Institutions. It presented a study that showed that in the New York area most checks drawn on local institutions did not return to the bank of deposit within a 7-day hold period. In fact, only 1 percent of all returned checks returned within the 7-day hold period. Only 10 percent of nonlocal checks that were returned were returned within an 11-day hold period.

Tampering with the magnetic strip on the check, which interferes with the forward movment of the check from the bank of deposit to the payor bank, can further delay this check clearing process.

And of course, as was discussed in the discussion with Governor Angell, check holds provide no protection against forgery either. Banks do not routinely analyze a check when they are asked to pay on it, to honor it, to ensure that the endorsements are authentic. Rather they use computer equipment for processing purposes. The first time that a forged signature endorsement would be discovered is when the customer opens his bank statement at the end of the statement period. Obviously, even a long hold period would pass before this discovery is made and notification is made.

In sum, we believe consumers deserve relief from long check hold practices and that our proposal for a 1-to-3-day schedule, with exceptions, should be put into place immediately.

Thank you.

Senator Dodd. Thank you, Ms. Meier. Mr. Fox.

STATEMENT OF ALAN FOX, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. Fox. Thank you, Mr. Chairman.

My name is Alan Fox. I am legislative representative for Consumer Federation of America [CFA]. CFA is a coalition of over 200 national, State, and local organizations, and on behalf of all of those organizations and on behalf of the other organizations represented here, I want to express to you our deep appreciation for your leadership on this issue and for your introduction of S. 344.

We have encouraged and will continue to encourage Members of the Senate to cosponsor this bill. We believe it is certainly a significant improvement over the bill passed by the Senate in 1984, and we share your hope that the committee and the full Senate will consider and adopt S. 344 expeditiously.

In that spirit, and with that background, I want to spend some time going over some of the proposed improvements that we have previously submitted in writing, improvements which we believe will help ensure that the purposes of the bill are fully carried out.

THREE CRITICAL ISSUES IN THE PRESENT BILL

I would like to concentrate on three of those issues that we think are most critical.

First, under the bill as written, consumers must wait too long for relief. Second, even after that relief arrives, many checks will still be held for too long a period, and finally, we believe that the Federal Reserve Board is given more discretion than is desirable in designing the system to meet the goals of the bill.

First, the bill provides no relief to consumers until 4 years after its enactment. We don't believe that the consumers who have waited for at least 10 years for action should now be expected to wait until 1991, at the earliest, before they will see significant improvements in check clearing times. Even the Federal Reserve Board today and at previous hearings in the past couple of weeks has testified that regulations significantly shortening current hold periods could be adopted and implemented in a much shorter period than 4 years.

We propose that either of two options be looked at. The first is an interim schedule which would go into effect, pending the final rule and the final goals stated in the legislation, or in the alternative, early implementation of the system of short hold periods, with exceptions as described, as one of the two options in the bill, that that implementation could occur at a period much less than 4 years.

Second, even after 1991, as the bill is now written, maximum hold periods of 4 or even 5 business days are permitted under one option, and under the other option, there's no maximum stated at all. We believe that even under current conditions, 4 and 5-day hold periods are certainly too long, and they are certainly longer than will be needed after a 4-year phase in of the implementation of the bill.

A 4-business day hold period works out to a full week. Including weekends, and using an intervening day count, that 4-day hold equals a full week and that simply bears no relationship to the time that is needed for a bank to receive provisional credit, even on an out-of-State check.

The maximum period that is set in the bill under either option has clear implications for other, shorter, limits that are set by the Federal Reserve, since the Fed authority, to set those other time levels, depends on provisional credit, in whole or in part. We believe that a reasonable interpretation of the bill would allow local checks, which generally take 1 day less than distant checks to receive provisional credit, to be held as long as 3 days under the language as written.

We don't believe that is your intent. We don't believe that that is what is reasonable for consumers to expect, and we hope that those periods can be shortened.

Now you have heard, finally, and you will continue to hear that the bill provides not enough discretion to the Federal Reserve Board in implementing the system. It is our belief that the bill provides more discretion than is desirable. Given the history of inaction by the Federal Reserve Board, we simply don't have the confidence that the consumer interests are going to be met by providing the Fed with the sorts of discretion that we have described.

We are reluctant to rely on the Fed to the extent the bill does. We have identified, in my previous comments and in the written statement, some specific instances in which this reliance could lead to unintended consequences, including exceptionally long local hold periods.

Now I would say that the proposal is much improved over some previous attempts in this regard, but we believe it's not sufficiently improved.

Additionally, the Fed's response—Governor Angell's response today—is certainly encouraging that perhaps the Fed has turned over a new leaf and will begin to take these issues more seriously. The bottom line, however, the basic problem is that consumers don't have any way to hold the Federal Reserve accountable, and so we come to you and rely on the Congress to provide the protection that consumers need, because we haven't gotten that protection from the Federal Reserve Board.

Thank you, Mr. Chairman.

Senator DODD. Thank you all very, very much for your statements, very clear and concise, and they are very helpful as well. And let me add, as well, I found your written statements very adept and very worthwhile, and I must say, I have a couple of concerns—I think the 4 years—my own concern is 48 months is a rather lengthy period of time. We may be able to do something in that regard.

Let me just ask a couple of questions, if I can.

Mr. Cooper, and I think you, as well, Ms. Livingston, talked about a couple of the studies. I think all of you addressed the study issue, but particularly you, Mr. Cooper. Since the PIRG has done a couple of studies as you point out, surveys of institutions across the country, could you describe in a little more detail how your studies were conducted?

Mr. COOPER. The U.S. PIRG study was conducted by State PIRG's during the spring 1986.

Senator DODD. Let me ask you, as well, not only how it was done, because what I am getting at is why do we come up with such dramatically different results?

Mr. COOPER. Excuse me?

Senator DODD. There are always such dramatically different results that we we get when you get the ABA or Fed studies and your studies, and I wonder if you might comment on that as well.

NO SIGNIFICANT DIFFERENCES ON 1985-86 STUDIES

Mr. Cooper. Well, I don't know that I can comment on why the ABA results are different. PIRG made studies over 2 years. These studies contain data from 11 States dispersed throughout the country, and the information was gathered the first year from well over 600 institutions and the second year from over 450. Banks were contacted by telephone, asked about their check hold policies, and the researcher requested information on the length of time an established customer could expect deposited funds to be held. That is the basis of the information.

There was no significant difference in the results gathered in 1986 from the results gathered in 1985 in the PIRG study.

Senator Dodd. Who did they speak to? Who are they speaking to?

Mr. Cooper. They are speaking to bank officers and bank employees familiar with check hold polices.

Senator Dodd. Bank officers.

Ms. Livingston. Mr. Chairman, if I can add a comment to that question.

Senator Dodd. Yes.

Ms. Livingston. You asked about the discrepancy between some of the consumer studies and the banking studies. I think one thing that should be pointed out is that the American Bankers Association did do a study about the incidences of holds, but one of the things about that study was that when they looked at their base, which is the number of checks that are deposited, they didn't separate commercial checks, checks that are deposited into commercial accounts from checks that are deposited into consumer accounts. Our understanding is that checks that are deposited into commercial accounts are rarely subject to holds, and so I think that the study is very skewed, because there was not that kind of separation in deposits.

Senator Dodd. Does anybody else want to comment on those studies?

Ms. Meier. Well, I think the effect of what Ms. Livingston described as the really inappropriate base attributes a lot to the discrepancy. Also, I think it should be kept in mind that the study really involved a self-selected sample. We saw the form, the questionnaire that was sent out as the basis of the study. There was an "URGENT" in caps written at the top of the questionnaire, with an indication to whomever would have read it that the study was being done in connection with the imminence of check hold legislation passing.

So one can imagine that the industry members who may have had good check hold policies would have responded to the survey rather than those who did not.

Mr. Fox. You mentioned the Fed studies as well. The Fed studies that I have seen are asking an entirely different question. They are not generally seeking to determine what banks hold policies are, but as I think Governor Angell described, they are asking consumers if they have had problems with lengthy hold periods.

Those studies which have been conducted every 2, 3, 4 years over the past decade or so have indicated that, in the most recent one, U.S. PIRG

STATEMENT OF

SAMUEL [illegible], LEGISLATIVE REPRESENTATIVE

UNITED STATES PUBLIC INTEREST RESEARCH GROUP

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

of the

UNITED STATES SENATE

January 22, 1987

U.S. Public Interest Research Group (U.S. PIRG) is the national lobbying office for state Public Interest Research Groups across the country. PIRGs are non-profit, non-partisan consumer advocacy organizations. One of our major priorities is the passage of legislation limiting the holds financial institutions impose on funds deposited by check.

State PIRGs have long been in the forefront in addressing the problem of delayed funds availability in their states. Responding to numerous complaints from consumers, state PIRGs have studied and surveyed bank check hold policies and their justifications. As state by state studies documented the problem, PIRGs began campaigns in many state legislatures to provide relief to consumers.

Restrictive check hold policies are indefensible and unfair to consumers. Since states may not regulate federally chartered banks, federal standards are necessary. U.S. PIRG is pleased to join with the chairman and all the members of this committee who are attempting to address this consumer problem through the national legislative process. It is time that consumer grievances be addressed with action instead of additional studies, pilots or recommendations. We urge prompt action on this issue to relieve consumers of an unnecessary hardship.

Why are holds a problem?

According to a nationwide survey of 456 banks and savings and loans conducted by U.S. PIRG, 75 percent of the institutions surveyed hold out-of-state checks for six business days or more. Twenty percent hold these checks more than two weeks. A Washington, D.C. area survey by Congress Watch found that 25 percent of local institutions even place holds on U.S. Government checks, and half of the institutions hold payroll checks. Check hold periods of as long as 20 business days -- nearly a month -- have been identified.

Lengthy holds have caused widespread frustration, hardship, and monetary loss to consumers. Not only is access to needed funds denied, but consumers are subjected to overdraft charges averaging $15 per check for checks written on held funds, as well as late penalties assessed by utilities and other vendors to which these checks are written.

The large percentage of Americans who live from paycheck to paycheck bear an even heavier burden. With no cushion of excess funds, many face difficulties in meeting basic living expenses while they wait days or weeks for deposits to clear.

Are holds profitable for banks?

Hold periods bear no relationship to the time actually needed for banks to collect funds deposited by check. The Federal Reserve Board estimates that 99 percent of all deposited checks are collected by banks within one or two business days. These funds are immediately invested by the banks but are withheld from customers. Depository institutions are able to take hundreds of millions of dollars each year through hold practices.

The profits from investments during the float are bloated by bank income from overdraft charges imposed on checks written on held funds. A 1985 survey by the Consumer Federation of America found that bounced check charges average over $15. The 9.7 million checks bounced every year because of check holds thus cost consumers an estimated $175 million annually in overdraft charges alone.

Will losses increase under mandated holds?

Banks continue to justify their lengthy holds by unsubstantiated claims that they prevent bad check losses. However, lengthy holds are not effective protection against intentional efforts to defraud a bank by depositing a bad check. For example, by tampering with a check's magnetic strip, which routes the check through the clearing system, a criminal can greatly delay the check's forward movement to the bank on which it is drawn. Even an extremely long hold period can pass before the dishonored check returns to the bank of deposit. Consequently, bad check losses should not increase under strong check hold legislation.

Long holds are similarly ineffective against forgery. When a check reaches the bank on which it is drawn, that bank must quickly decide if the check is "good." If the bank decides to dishonor the check, the payor bank must return the check by midnight of the day following the day of receipt. Because of the time constraints imposed by the midnight rule, payor banks do not rountinely analyze checks for forgery. Consequently, as long as there are funds in the account to cover a check, and the check appears valid on its face, the bank will normally pay on it. In this situation, the hold clearly does not serve any protective purpose.

Further, the current level of bad check losses is miniscule. The Federal Reserve reports that 99 percent of all checks are paid the first time through the collection process. Of the one percent that are returned, more than 60 percent are for amounts less than $100; and approximately half are paid the second time through the collection system. In the end, only one in evey 5,245 returned checks must be written off.

The U.S. PIRG study documented that 18 percent of the banks grant access to local checks immediately, while 10 percent grant access to out-of-state checks within two business days. These figures demonstrate that banks are able to grant consumers quick access to their funds without inordinate risk.

In fact, according to bank regulators in states that have hold laws, banks have reported no significant increase in losses under the state imposed ceilings. This is true even in Massachusetts, where regulations allow only two day holds for checks drawn on banks within the entire New England area, and four day holds for checks drawn on banks outside of New England.

Have voluntary efforts worked?

The banking industry and federal regulators have been studying the check hold problem since the 1970s. Yet despite continued public outrage, congressional prodding, and extensive hearings in both the House and Senate, neither voluntary industry efforts nor action by the federal regulators have provided consumers with relief. Surveys conducted under the auspices of the Federal Reserve Board show that the number of consumers reporting problems with delayed funds increased between 1983 and 1986 despite growing attention and pressure to improve hold practices.

What type of legislation is needed?

Federal check hold legislation must establish a mandatory maximum hold schedule with exceptions only allowed in specified circumstances involving potential risk. The maximum schedule should give consumers access to their funds no later than the one to two days required for banks to collect on the funds. In addition, legislation should be enacted ensuring that bank fees are more reasonably related to costs.

In January of this year the Chairman of the House Banking Committee, Fernand St Germain (D-RI), introduced check hold legislation. The Expedited Funds Availability Act (H.R. 28) established a ceiling on hold practices. Three years after its enactment, funds must be made available:

- by the next business day for checks under $100, government checks, and cashier's checks;
- by the next business day for in-state checks; and
- after three intervening business days for checks drawn on out-of-state banks.

The House bill also gives banks flexibility to avoid the hold schedule in the following circumstances: deposits into new accounts, deposits in excess of $5,000 per day, deposits into accounts with frequent overdrafts, and checks drawn on foreign banks. Moreover, the bill authorizes the Federal Reserve to temporarily suspend portions of the Act if suspension is necessary to reduce losses due to check-related fraud. Essentially the same bill passed the House in the 99th Congress by an overwhelming margin.

A much weaker bill passed the Senate in the last days of the 99th Congress. The Senate bill directs the Federal Reserve Board to issue regulations to meet the "goal" of providing one to three day funds availability. Considering the Federal Reserve Board's history of inaction on this issue and its conflicting role as an operator of check collection facilities, the bill offers little hope of improvement for consumers.

Any Senate bill must, therefore, establish a maximum hold schedule similar to the one established by the House bill, rather than goals for administrative action. Until the Senate acts on such a proposal, the hold up will not only be at the bank but also in the Senate chambers.

15 percent of all consumers reported a problem caused by a hold being placed on a deposit. I think that is indicative of a pretty widespread problem. There are very few consumer issues that we run across that affect 15 percent of all consumers very directly. When we talk about most issues, it is often a relative handful of consumers who are facing abuse or facing a problem.

That 15 percent, I think, results in an estimate—15 percent of households with accounts—of roughly 10 million households that have run into a problem, and that seems to be validated by other Fed statistics that indicate that approximately 10 million checks a year bounce because they are written against funds that have been deposited but have not been collected, in other words, against funds that are on hold.

I think that is probably the best measure of the problem. The 10 million times a year consumers write checks against funds that they believe are available and, in fact, end up bouncing those checks because the funds are not available.

Senator **Dodd**. Senator Shelby.

Senator **Shelby**. I want to address this question to Mr. Lawrence. Mr. Lawrence, in your hometown or home bank there in the Philadelphia area, tell us again about your depositing the funds and they were held how many days?

Mr. **Lawrence**. Well, it was over 1 week.

Senator **Shelby**. Over 1 week.

Mr. **Lawrence**. Yes. The deposit had been made over 1 week before, and it involved checks which had been written on out-of-city, and I think out-of-State banks like New York City, for example, that distant place from Philadelphia.

Senator **Shelby**. You can just about see it, can't you?

Mr. **Lawrence**. Yes. [Laughter.]

Senator **Shelby**. And you think your situation is typical of the area?

Mr. **Lawrence**. I think it is typical of communities of that size. Now, it is possible, of course, the next largest city is some 7 miles from us. There are any number of banks in Philadelphia, although they are consolidating themselves, as you may very well know. So, there are only two or three major banks left, all in the form of holding companies, with their practices being somewhat different. By and large, the people of whom I speak are those who like to deal with a bank which is close by, a bank maybe they can walk to or certainly get to conveniently.

So, they are in a position where they have to deal with this one bank or none at all.

Senator **Shelby**. Do you believe, without legislation, that the Fed is going to do anything—really do anything about this hold period?

Mr. **Lawrence**. No, sir, I don't. I am afraid not.

Senator **Shelby**. What about the other panelists?

Ms. **Meier**. Certainly, the testimony of Governor Angell is a striking contrast from the testimony we have heard to date. I think that there is some indication that they are interested in improving the check clearing system. I am not sure that it is so much motivated by their concern over the check holding problem for consumers, as much as the fact that the current check clearing system does provide such ineffective protection against bad checks, because the return system is so long, and that check holds can not actually protect a bank against bad check losses at this point in time.

So there has been some industry pressure over a long period of time for the Fed to do something about that problem.

Senator SHELBY. I personally believe that they see this legislation about to move, and that is why they are getting things done. [Laughter.]

Ms. MEIER. I think there's been some fortuitous dovetailing here. [Laughter.]

Senator SHELBY. Thank you. Thank you, Mr. Chairman.

Senator DODD. Thank you, Senator Shelby.

I will ask this question of all of you, since it is joint testimony.

Mr. Fox, you particularly brought it up, and that is having the Congress, in this particular area, because of the lack of real accountability with the Fed, which has been an ongoing issue, going back to the days of Wright-Patman. I think the very first bill I ever cosponsored was Wright-Patman's trying to get an accounting of the Fed. But for instance, in the definition of new accounts and other such areas, I appreciate what you are saying, except that I sometimes feel that while there is, obviously, much closer access between constituents and the Congress than there is between constituents and the Fed, and on that level, obviously, it makes more sense, when possible, for Congress to be more specific.

FLEXIBILITY TO AVOID FRAUD

My concern in this particular area is that while our intent may be to try to do something that improves consumer protection in this area, that too often, when we try to define these areas, we create more problems. For instance, in defining new accounts, it would not be inconceivable that someone could very quickly decide to avoid this kind of a thing, using some of the definitions we have talked about. If you really wanted to engage in some fraudulent activity, run around and establish 100 new accounts and scheme, deposit checks for less than what would be the triggering amount, whatever that number may be, say, $1,999 or $2,999 or $4,999, deposit those checks, get your cash and run. And yet we would have defined new accounts and done something which, at least on the surface, would have appeared to have been a significant improvement for consumers, and yet might be, in fact creating a tremendous window of opportunity for those who want to engage in fraudulent activities.

Do you see what I am driving at in that regard?

Mr. FOX. Well, I do. In the instances you are giving, the only question is whether Congress puts some numbers in the law or the Fed puts some numbers in regulation. In either event, you can construct a scenario that says that somebody waits X plus 1 and deposits a check of Y minus 1, and they get away with it in some way. We can construct those scenarios endlessly. I think the argument is being made that the Fed would somehow have greater flexibility, if it saw something like that happening on a wide scale to change those numbers. Given the rulemaking process, which all of us have participated in on other issues, in some cases to endless detail and endless amounts of time, I don't know that the Federal Reserve can necessarily act more quickly on an issue like that than Congress nor that the Federal Reserve can develop more or better information on what an appropriate period of time or an appropriate dollar figure would be than Congress can.

We have some experience now with several State laws. That is something that can provide Congress some guidance, and I think the argument for flexibility really doesn't apply here.

Senator Dodd. Maybe too what you were suggesting with regard to the 48-month, we might get at some of this a bit. That is a pretty healthy block of time, whereas you talked about an interim process whereby you could—let me ask you in these terms.

Would you be more comfortable if we had some better way of monitoring this process over that period of time without giving a 4-year period of time to actually check on what the Fed is doing in this regard. I presume that would make it more palatable.

Mr. Fox. Well, I guess short of something that amounts to a legislative veto of the rulemaking, I am not sure that the time makes that much difference. I suppose you could write some temporary provisions into the law that would take effect very soon and then require the Fed to have its rules out with enough time before they go into effect to allow Congress to come back and look at it. That may provide an answer, but on most of the issues that we are talking about, I think Congress has the information, has the ability to set the sorts of parameters that would make the law work and make it work effectively, without referring to the Fed, having everybody go through a long, involved detailed process and then coming back to Congress for a second shot.

Senator Dodd. Let me ask one other question, and you can all respond to both questions, so we can abbreviate this a bit.

Do I understand, despite what the motivation may be, and I suspect that my colleague from Alabama and Mr. Lawrence are probably more right than not, and that is what I consider, I think what all of us consider to be very positive testimony this morning on the part of the Fed. I don't delve too deeply into motives, if I can get a good positive statement of support, I have found that to take it or run with it is better counsel. [Laughter.]

But as I understand it, what you are saying is, whatever the motivation may be, none of you object, as I understand it, to efforts to expedite this process, to abbreviate this process, to shorten the return process. And I would appreciate your commenting on that.

Do you approve of that as a goal? And second, how do you address the question of abbreviating the return process versus the exception process, which worries me. I see the exception process as one that can be abused, where institutions, banks can find more reasons for exceptions. Whereas if the return process is abbreviated, it seems to address, rightly or wrongly, the concerns raised by banks, as well as certainly improving the present situation for the consumer.

I wonder if you might address that particular question, all of you, and you can begin with you, Mr. Fox, if you would like. The rest of you can respond to that first question, as well.

Mr. Fox. First, as we stated, we do not believe that improvements in the return process are necessary in order to shorten hold periods substantially.

IMPROVEMENTS IN THE RETURN PROCESS

Second, improvements in the return process do have some value and ought to be a part of the consideration. We only observe that if they were cost effective and useful to the industry, they probably would have been implemented more expeditiously. There would be greater interest in doing so by now, and I think what we will find out is that because such a small proportion of items go through the return process, there may very well be cost problems in relying entirely on a system of expedited return or expedited notice, really, which is really the goal here.

So that is something that has to be balanced, and we are certainly comfortable with the Fed doing that balancing. We think, to some degree, the industry's been doing that balancing all along and hasn't found it cost effective.

Ideally, and the cost consideration aside, I think we would very much agree that a system that had short funds availability periods with no exceptions necessary because the return process worked so well, would be desirable for exactly the reason you've stated, that it eliminates or reduces significantly the potential for abuse of discretion by the banks.

Ms. **Meier**. We believe that improving the check clearing system and return item processing is perhaps a worthy goal to eliminate the losses that occur under the current system. However, we certainly do not believe that it is a necessary condition precedent to actually going into a 1-to-3-day availability schedule, with exceptions, in the very near term. An exception-based system, based on provisional credit, is what exists in Massachusetts and what is the basis for a relatively large and significant number of members of the industry now.

So we think it is a worthy goal but not something that we have to rely on before we go into the system that is able to be put into place now.

Regarding the Fed flexibility issue, whether or not there should be any increase of discretion given to the Fed, as you know, we are concerned with the amount of discretion given to the Fed already. I think we would feel very strongly opposed to giving the Fed any more discretion. I couldn't get a clear sense of what Governor Angell specifically is requesting in the way of flexibility, but I got the sense that the Fed would like to have more flexibility in defining the actual schedule.

We would be very, very, very opposed to any discretion in that area. We already believe that the schedule is too flexible toward the Fed.

Senator **Dodd**. Thank you.

Ms. **Meier**. Especially when we have a system that could be put into place today.

Senator **Dodd**. Thank you very much.

Mr. **Lawrence**. Senator?

Senator **Dodd**. Yes.

Mr. **Lawrence**. Oh, excuse me.

Senator **Dodd**. No, go right ahead.

CONSUMERS HAVE BEEN BLANDLY IGNORED

Mr. LAWRENCE. In my earlier remarks, I said nothing about the mechanics of the system, simply because I think that the vast number of people know nothing about the mechanics, could care less about them. They know the goal. They want something to be done. They want a shorter hold time, if any hold time at all is necessary. But from the point of view of the American Association of Retired People, which understands that you just can't order the goal achieved, I think our early preference was that this body would direct the adoption of a schedule of check hold that would meet the needs of all the people. One inevitably gathers the impression from listening to representatives of the banking fraternity speak largely of matters of what is their own convenience and what would be good for them. And I think the Senate must represent the vast number of people here whose own needs have been, I think, sadly neglected here and ignored, blandly ignored.

So for whatever reason, and I am not aware of the certainty of this, but for whatever reason, if the Senate and the House cannot agree on this mandate of a particular schedule of check hold time and the Federal Reserve must then be involved, our strong preference would be that in the legislation that there be specific parameters described within which the Federal Reserve banking system then would operate.

I think that just a broad grant of power with the total discretion of the Fed to do with it pretty much as it saw fit in achieving a general and rather abstract perhaps objective for them would not be satisfactory, sir.

Senator DODD. Thank you, Mr. Lawrence.

Sam.

Mr. COOPER. We oppose giving the Fed any more discretion. Over the past 10 years, they have not been responsive. Governor Angell seems very earnest in his testimony, but certainly, anything that is done here in the Congress will postdate his tenure at the Federal Reserve. I think that it is an important goal to improve the return process and make it more efficient, but I think that generally that is a different issue and such improvement should not hold up congressionally mandated ceilings on check hold periods. The current experience that we have with various States that do have mandated ceilings indicates that there have been no significant increase in fraud by the banks affected and the Fed has testified earlier today that they do not have any information that shows that banks that are under mandated schedules have had any problems with respect to losses.

Ms. LIVINGSTON. I agree with what has been said so far, so I will be brief.

I think what needs to be remembered is that in this area Congress really doesn't have to start with a clean slate, and that is because States have acted in this area, and as Sam has said, they have had very successful experience. And I would stress this in regard to the exceptions, such as the exceptions for new account holders and for large dollar amounts, where the States have set specific exception by days for new account holders and for large dollar amounts and have not experienced losses under that type of scheme.

I would also like to echo Michelle's remarks with regard to the improved return system. Our basic concern is that we don't think that that improvement should be a condition for reduced hold periods. And again, I would point out that the experience that the States have had where Massachusetts already has 2 to 4 day availability without any improvements in technology. Because we think that that kind of system is workable today, we certainly wouldn't want it to be postponed because of a lack of improvement in technology.

Under the current bill, even if the return system is improved, there is still up to 5 intervening days that the Fed could allow in terms of customers getting access to their checks, and that is already greater than Massachusetts law, which is in place today.

Senator DODD. Well, thank you very much.

Senator Shelby, do you have anything?

Senator SHELBY. No.

Senator DODD. Well, I thank all of you for your very constructive suggestions and your comments here this morning. They are very, very helpful, and obviously, in the next few weeks, as we try and move on this, as I mentioned at the outset, as quickly as possible, we will be in touch with you in trying to put together a bill here that we can get to the floor and get enacted and, hopefully, get—I understand the House may move in the next couple of weeks on this particular matter or something similar to it.

Whether or not this will be a part of something larger or on its own, is something I don't know the answer to yet, quite honestly, but I am determined to see to it that we not wait around another 4, 5, or 6 years, as we have. Patience has run itself out on this side, and so it is a question of the vehicle, and what this committee and the Senate is willing to accept and to move on.

So I thank you for coming this morning.

We have been notified we have a live quorum call by the leader and have to go to the floor. I am also going to ask my good friend and colleague, Senator Shelby from Alabama, when we return, if he will take over chairing this subcommittee for a little bit. I have run into the conflict that happens all the time but they have rescheduled a markup on a hearing in one of my other committees in which I am deeply involved. So I am going to have to be there for—it's been going on for 1½ hours. I have to be there for a little bit.

So for the next panel, I will try and come back in before you complete your testimony, but we will take, say, a 10-minute recess here to give us a chance to vote and then come back.

The committee will stand in recess for 10 minutes.

[Recess.]

Senator SHELBY. If the second panel will come up. That's Mr. Hewell, Mr. Wilhelm, and Mr. Monks.

Your written testimony has been sent to us and will be made part of the record without objection, and if you gentlemen would sum up your testimony as briefly as you can we would appreciate it. Who wants to start out?

STATEMENT OF ROBERT C. HEWELL, CHAIRMAN OF THE BOARD, RIVER OAKS BANKS, ON BEHALF OF THE HOUSTON CLEARING HOUSE ASSOCIATION, ACCOMPANIED BY FRED J. REDEKER, EXECUTIVE VICE PRESIDENT, HOUSTON CLEARING HOUSE ASSOCIATION

Mr. **Hewell**. Mr. Chairman, I represent the Houston Clearing House Association as chairman of its legislative and regulatory committee. Accompanying me is Fred J. Redeker, who is executive vice president of the Houston Clearing House Association. Our association includes approximately 265 banks located in the Houston area. This statement also represents the position of the North Texas Regional Clearing House Association, a greater Dallas association representing an additional 250 financial institutions. Together, these two associations represent over half of all banking assets in Texas.

Before discussing the specifics of S. 344, our association would like to express its support for your efforts to accelerate our Nation's payment system. We are well aware, not only as bankers, but also as consumers, that an accelerated payment system will be of invaluable benefit to all concerned. Our association therefore supports efforts to achieve an accelerated system in a reasonable timeframe at a realistic cost to the consumer and our banks.

COMMENTS ON FIVE AREAS

I would like to divide my comments on the bill into the following areas: Regulatory involvement in an accelerated return system; problems in mandating a payment schedule; Federal preemption of State statutes; deposits with questionable collectability; and, competitive equity for private providers of clearance services.

First, we are supportive of the emphasis placed in section 5(b) of S. 344 to require the Federal Reserve to improve our Nation's check clearing process by expediting our return process. Such a provision addresses the key problem; namely, the highly manual return check processing system. In addition, given the extreme complexity of the payment system in terms of institutions, geography, technology, and competitive relationships, it would be difficult to adhere to an inflexible availability schedule. We also support granting the Federal Reserve discretion as to defining new accounts, determining the size of deposits that are subject to an availability schedule, and providing standards for the treatment of repeated overdraft accounts.

Second, our association is concerned that mandating a funds availability schedule of 4 intervening days—which we recommend be clarified to business days—after the day of deposit and 1 additional day at the Board's discretion, may not be workable. We raise this question, taking into consideration the present limitations imposed by our Nation's payment system and promising new approaches, such as the Valley National Bank test, which have not yet been fully proven on a nationwide basis. We believe that only through improvements in the check return system will depository institutions be able to comply with a shorter availability schedule.

Senator **Shelby**. Mr. Hewell, can I interrupt you just a minute?

Mr. **Hewell**. Yes, sir.

Senator **Shelby**. You're reading your testimony. Can you just orally summarize it because we've got some real time constraints. We have your written testimony which will be made part of the record and we were wondering if you could summarize orally in just 3, 4, or 5 minutes because of time constraints of what your main points are.

Mr. **Hewell**. Let me try to do that. It was about a 5-minute reading.

Senator **Shelby**. We have your written statement though and that will be made part of the record, but because of time limitations we would like you to summarize orally the points that you wish to make so these other gentlemen will have a little time.

Mr. **Hewell**. Let me go through the points again. We certainly want the Federal Reserve Board to have the flexibility to set scheduling and it is felt that the alternative in the bill of possibly requiring for 1 day provisional credit is unworkable because it does not accomplish a true change in the return item method. I understand that the Federal Reserve Board is in agreement on this point.

Furthermore, we believe that the Federal Reserve Board should be given the flexibility to grant exceptions in good faith; otherwise a rigid schedule could ultimately be harmful to the consumer. Clearly, there is no way that a mandated schedule can anticipate all the valid exceptions that might arise and still be fair to the majority of consumers. Frankly, in the Houston area only one-tenth of 1 percent of the depositors have holds placed on their checks, unless the Federal Reserve has the flexibility I discussed, 99.9 percent of our customer base could suffer the consequences of an overly strict law.

I would like to stress that we are concerned that by assigning this responsibility to the Federal Reserve that we do not lessen the opportunity for the private sector providers to fully participate in the payments system.

Thank you.

[The complete prepared statement of Robert C. Hewell follows:]

STATEMENT OF

ROBERT C. HEWELL
CHAIRMAN OF THE BOARD
RIVER OAKS BANK

ON BEHALF OF

THE HOUSTON CLEARING HOUSE ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE COMMITTEE
ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

FEBRUARY 5, 1987

Mr. Chairman and Members of the Subcommittee, I am Robert C. Hewell, Chairman of the Board of River Oaks Bank in Houston, Texas. Today, I represent the Houston Clearing House Association as Chairman of its Legislative and Regulatory Committee. Accompanying me is Fred J. Redeker, Executive Vice President of the Houston Clearing House Association. Our association includes approximately 265 banks located in the Houston area. This statement also represents the position of the North Texas Regional Clearing House Association, a Greater Dallas area association representing an additional 250 financial institutions. Together these two associations represent over half of all banking assets in Texas.

Before discussing the specifics of S.344, our association would like to express its support for your efforts to accelerate our nation's payment system. We are well aware, not only as bankers, but also as consumers, that an accelerated payment system will be of invaluable benefit to all concerned. Our association therefore supports efforts to achieve an accelerated system in a reasonable time frame at a realistic cost to the consumer and our banks.

I would like to divide my comments on S.344 into the following areas: regulatory involvement in an accelerated return system; problems in mandating a payment schedule; federal preemption of state statutes; deposits with doubtful collectability; and, competitive equity for private providers of clearance services.

First, we are supportive of the emphasis placed in Section 5(b) of S.344 to require the Federal Reserve to improve our nation's check clearing process by expediting our return process. Such a provision addresses the key problem; namely, the highly manual return check processing system. In addition, given the extreme complexity of the payment system in terms of institutions, geography, technology and competitive relationships, it would be difficult to adhere to an inflexible availability schedule. We also support granting the Federal Reserve discretion as to: defining new accounts, determining the size of deposits that are subject to an availability schedule, and providing standards for the treatment of repeated overdraft accounts.

Second, our association is concerned that mandating a funds availability schedule of four "intervening" days (which we recommend be clarified to "business" days) after the day of deposit and one additional day at the Board's discretion, may not be workable. We raise this question, taking into consideration the present limitations imposed by our nation's payment system and promising new approaches, such as the Valley National Bank test, which have not yet been fully proven on a nationwide basis. We believe that only through improvements in the check return system will depository institutions be able to comply with a shorter availability schedule.

Imposing a schedule will not resolve our problems. Nationally, while it takes only an average of 1.6 days for a check to be presented to the payor bank, it still takes an additional 5.2 days for an unpaid check to be returned to the depository bank.

In fact, fifteen percent of all returned checks still take ten or more days to complete the round trip from the depository bank to the payor bank and back again. This means that the return process still takes three times as long as the presentment process.[1] In addition, experience by a number of individual states shows that the primary regulators require flexibility to successfully supervise availability schedules. We, therefore, urge you to grant the Federal Reserve additional discretion to extend the availability schedules.

We are encouraged by the forty-eight months period granted to the Federal Reserve Board to develop an accelerated check clearing system after the enactment of Congressional legislation. However, it should be noted that for banks such a time frame may also require a significant and costly investment in new technology, the cost of which will have to be passed on to the consumer. Even with best efforts after forty-eight months Federal Reserve tests may show that there is no reasonably cost effective measure to implement such a schedule. If this occurs, Congress should be ready to consider extending the time granted to the Federal Reserve beyond the original forty-eight months.

We are hopeful that you will reconsider Section 5(c) of S.344, which by requiring funds to be made available upon receipt of provisional credit, will impose a considerable burden on depository institutions. Such an approach does not take into consideration the effect on safety and soundness of an institution, nor limitations imposed by our payment system which may bring about situations where a check would be returned unpaid to the bank of original deposit after the funds had already been made available and withdrawn.

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[1] Statement of Preston Martin, Vice-Chairman, Board of Governors, Federal Reserve System before the U.S. House Banking Subcommittee on Financial Institutions Supervision, Regulation and Insurance, 99th Congress, 1st Session. (1985).

Third, S.344 provides that state laws or regulations on funds availability shall supersede any federally promulgated law if the state law provides for a shorter period of time in gaining access to the account. On balance, we believe that state laws should not preempt federal laws in funds availability requirements due to the national nature of the system. A national approach should take precedence over any system established by individual states, if Congress enacts workable legislation. Moreover, a uniform federal response is the most reasonable way to assure that depositors throughout the United States are treated fairly in gaining access to funds in their accounts.

Fourth, we are supportive of your effort to provide depository institutions exceptions with an exemption from any schedule in case of reasonable suspicion that funds are uncollectable, have been diverted, or delayed in transit. As you are aware, the circumstances under which a depository institution may have a legitimate and reasonable cause to believe a check to be uncollectable are numerous. Absence of such an exception in such situations would require depository institutions to protect themselves by refusing to accept a check for deposit or to accept it only on a "collection" basis. This would not be a satisfactory solution. It is costly to both the consumer and the depository institution and may delay even further the availability of funds. We believe that S.344 through this provision balances the need of the consumer to have access to funds with the need to protect depository institutions from undue harm. Allowing banks the flexibility to make a good faith judgment on the collectability of any deposit is particularly appropriate when frivolous law suits regarding a bank's lender liability are on the increase.

Fifth, our association believes that any federal legislation in this area should explicitly maintain the competitive balance between private providers of clearing services and the Federal Reserve, who, in addition to being our main regulator is also the principal competitor. We specifically request you to consider language which would ensure that private sector providers of payment services will have an equal role in providing new services resulting from this legislation. While the Monetary Control Act of 1980 has created a fragile balance between commercial banks and the Federal Reserve, we wish to avert future problems. Even now we are experiencing some difficulty because banks without correspondent relationships cannot easily settle between themselves without Federal Reserve assistance. Also, local exchanges through clearing houses that were mutually beneficial to banks and the Federal Reserve prior to the 1980 Monetary Control Act, now provide an unfair advantage to the Federal Reserve. If, in the final analysis, the effect of federal legislation is to grant the Federal Reserve a monopoly over the development and deployment of new services contemplated, consumers over the long term will not be well served.

Senator SHELBY. Thank you.

Mr. Wilhelm.

STATEMENT OF GREGORY O. WILHELM, VICE PRESIDENT AND FEDERAL LEGISLATIVE COUNSEL, WELLS FARGO, SAN FRANCISCO, CA, ON BEHALF OF THE CONSUMERS BANKERS ASSOCIATION

Mr. WILHELM. Thank you, Senator Shelby.

I am Gregory O. Wilhelm, vice president and federal legislative counsel with Wells Fargo Bank in San Francisco, CA. I am appearing today on behalf of the Consumers Bankers Association.

In addition to my involvement with this issue on behalf of my own bank and CBA, I have worked extensively on it as chairman of the funds availability task force of the California Bankers Association. California is, as you may know, Senator Shelby, one of the States that already has enacted legislation in this area.

The CBA appreciates the opportunity to appear before the subcommittee to discuss the issue of funds availability and, more specifically, S. 344, The Fair Deposit Availability Act recently introduced by Senator Dodd. Although we understand the concern about this issue, we believe that financial institutions have made sincere constructive strides to address the problem and we ask that you continue to recognize the inherent risks we face in expediting availability of funds beyond the capabilities of return item system.

In this light, we particularly appreciate the comprehensive and thoughtful approach to this highly complex issue taken by both the chairman of the subcommittee and his staff.

While we support the goals of S. 344 and have consistently supported disclosure policies for funds availability, we are concerned that attempts to effect these goals may lose sight of principles that help assure the efficiency, safety, and soundness of the payment system.

OVERLY STRICT SCHEDULE RAISES CONCERNS

In this respect, an overly strict mandatory availability schedule raises particular concerns.

The CBA's position is generally consistent with many of the features of Senator Dodd's bill. In fact, our position basically is that if there is to be Federal legislation, we do ask that you review examples set successfully by States such as New York and California.

In these States, because of the complexity of the issue, the legislation does not contain specific availability schedules but delegates the setting of those schedules to the appropriate regulatory body.

In addition, similar to California and New York, legislation should either contain or instruct the regulatory body to establish appropriate exceptions for special cases where the schedule either cannot be met or places unreasonable risks on the depository institution. And to a certain extent, we think that Senator Dodd's bill does try to address this concern.

Perhaps most important, establishment of the availability schedule must be predicated upon modernization of the return item process.

Last, we ask that the subcommittee give serious consideration to a broad Federal preemption standard. Approximately 13 States have enacted dissimilar funds availability legislation. These State laws contain different disclosures, time schedules, and definitions. It may be difficult or even impossible to reconcile these approaches with a new overlapping Federal system.

As I have stated, S. 344 does contain certain features we believe are essential. Today, however, in the spirit of constructive comment, we would like to address some more particular concerns that we have as they relate to the bill.

The bill provides two alternative methods for defining a schedule for funds availability. The first approach, which we support, would require that the Federal Reserve Board improve the system in such a manner that it could promulgate a schedule within 4 years of enactment and under the improved system financial institutions could reasonably expect to learn of the nonpayment of any item within 4, possibly 5, intervening days. We are very encouraged by what Governor Angell said today about their ability to achieve that goal and I think all bankers—certainly those who are members of the Consumers Bankers Association—are confident that if the Fed can do it we can comply.

Under the improved system, a financial institution I think would primarily be relieved of most of the significant risks that are inherent today. I am making the assumption that the Fed, in fact, changes the system in such a way that we no longer need to worry about many of the things that cause risks today.

We are concerned about the second alternative in the bill. It basically would provide a scheme whereby in lieu of improving the return system the Board may promulgate regulations limiting the length of hold times to the time for provisional credit with a series of exceptions that an institution would have to rely upon to protect itself against real risks.

Provisional credit is determined by the check forwarding process only. It does not consider whether or not the item is collectible or how long it takes the item to be returned. Provisional credit is generally granted within 2 days of deposit and although the regulation permits various exceptions, it offers inadequate protection to financial institutions and, if adopted, we believe not only could it encourage fraud but the bill would also essentially relieve the Board of any responsibility for improving the return item system.

We would prefer to see the real focus placed on fixing the system with the Fed not having an option to implement some kind of backup system which does not actually improve the technology.

If the Board cannot adequately improve the system, may we suggest that you look at the schemes that are in place in New York and California as a workable alternative to this provisional credit with lists-of-exceptions system that is in section 5(c) of the bill. The practices in these States have proven satisfactory to consumers and relatively safe for financial institutions. Regulations in New York and California allow hold periods that are reasonably related to the actual amount of time required in most cases, not all cases, to learn of a returned item. And those regulations contain a list of exceptions which also provide adequate protection, similar to the exceptions that are in Senator Dodd's bill.

Last, let me just focus for one second on the problem of Federal preemption. We are concerned that the preemption standard that is in the bill today is inadequate. For example, under S. 344, the Fed, if it so chooses, can adopt a schedule that defines local and nonlocal items. It's a concept that has appeared in bills on the House side and it generally is consistent with a number of approaches to the problem.

The States of New York and California have addressed this problem in different ways. Our own scheme in California is quite complex but it does serve the needs of consumers and banks. We are very concerned that an overlapping Federal law which tries to provide consumers with the benefit of both State and Federal law may result in an extraordinarily complex system to implement and disclose. We would prefer that there be for the national payment system one funds availability system as well.

I note that my time has expired so I will bring my comments to a close and merely emphasize that we do have more detailed observations in our written submission and I encourage the subcommittee to examine that.

[The complete statement of Gregory O. Wilhelm follows:]

In conclusion, we are aware of the Subcommittee's concerns regarding the perceived problems in the check clearing process. But, according to a survey by our association, our member banks put actual holds on a minuscule percentage of deposited checks -- about 1/10 of 1%. Given the limited problems presently faced by consumers, we urge the Committee to be attentive to any excessive costs which may impose an unfair burden on the majority of our customers.

As I stated in my introduction, the Houston Clearing House Association and the North Texas Regional Clearing House Association support the ultimate aim of an accelerated nationwide payment system and looks forward to working with you and the Members of the Committee on this crucial issue.

Thank you.

TESTIMONY OF THE CONSUMER BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE OF CONSUMER AFFAIRS
THE COMMITTEE ON BANKING,
FINANCE AND URBAN AFFAIRS
UNITED STATES SENATE

PRESENTED BY GREGORY O. WILHELM
February 5, 1987

Mr. Chairman and members of the Subcommittee, I am Gregory O. Wilhelm, Vice President and Federal Legislative Counsel for Wells Fargo Bank, N.A., San Francisco, California. I am appearing on behalf of the Consumer Bankers Association (CBA)*. In addition to my involvement with this issue on behalf of my own bank and CBA, I have worked extensively on it as the Chairman of the Funds Availability Task Force of the California Bankers Association. California is, as you know, Mr. Chairman, one of the states that has already enacted legislation in this area.

The CBA appreciates the opportunity to appear before this Subcommittee to discuss the issue of funds availability and to comment on S. 344 the "Fair Deposit Availability Act of 1987" recently introduced by Senator Dodd. Though we understand the concern about this issue, we believe that financial institutions have made sincere and constructive strides to address the problem and we ask that you continue to recognize the inherent risks we face in expediting the availability of funds beyond the capabilities of the return item system. In this light, we particularly appreciate the Chairman's comprehensive and thoughtful approach to this highly complex issue.

CBA supports the goals of S. 344 and has consistently supported disclosure policies for funds availability. We were an early proponent of this concept as it was embodied in legislation introduced by the Chairman and subsequently incorporated into Senator Garn's omnibus banking bill. We also believe that depositors should be entitled to the use of deposited funds as rapidly as is possible and that interest on funds deposited into interest bearing accounts should be credited promptly. CBA is, however, concerned that attempts to effect these goals may lose sight of principles that help

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* The Consumer Bankers Association was founded in 1919 to provide a progressive voice for the retail banking industry. CBA represents approximately 700 federally insured banks, savings and loans and credit unions that hold more than 80 percent of all consumer deposits, and more than 70 per cent of all consumer credit held by federally insured depository institutions.

assure the efficiency, safety and soundness of the payments system. In this respect, an overly-strict mandatory availability schedule raises particular concerns.

CBA Position

If there is to be federal legislation, we ask that you review the examples set successfully by states such as New York and California. In these states, because of the complexity of the issue, the legislation does not contain availability schedules but delegates the setting of those schedules to the appropriate regulatory body. In addition, and similar to California and New York, legislation should either contain or instruct the regulatory body to establish appropriate exceptions for special cases where the schedule either cannot be met or places an unnecessary risk on the depository institution.

Perhaps most important, the establishment of an availability schedule must be predicated upon the modernization of the return item process. Today, the delays inherent in the return process impede the availability of funds. Lastly, we ask that the Subcommittee give serious consideration to a broad federal preemption standard. Approximately thirteen states have enacted dissimilar funds availability legislation. These state laws contain different disclosures, time schedules and definitions and it may be difficult or even impossible to reconcile these approaches with a new federal system. The relation of state to federal law is particularly important in the context of the national payment system which has evolved to ensure efficient and sound payment practices. In fact, the patchwork of existing state laws have impeded a resolution of the archaic check return system.

During the hearings before the Senate Banking Committee on January 23, 1987, CBA discussed the technical complexities of the national check collection system and other factors which have an impact on the availability of deposited funds. This discussion, which we have included again today, emphasizes the need for reasonable improvements to the return system before any funds availability schedule is implemented.

National Check Collection System

The question of deposit availability must be considered in light of the provisions of the Uniform Commercial Code, adopted by all states, and of the national check clearing system. When one bank takes for deposit a check drawn on another bank, it must send the check through the national check collection system to obtain the funds the check represents. Checks may be collected through a correspondent bank, the Federal Reserve System, a local check clearinghouse, or by sending the item directly to the payor bank on which it is drawn. In many cases, some combination of these methods is used.

The forward process of sending a check to the payor bank has benefitted from technology and generally takes only one or two business days from the date the check is first deposited. The actual time required will depend on a variety of circumstances, such as the location of the payor institution, the number of intermediary institutions involved, holidays, weekends, weather, and mechanical breakdowns.

The "depositary" (bank of first deposit) bank receives "provisional credit" for the check according to an availability schedule. That schedule reflects normal processing and transportation time for the forward process only, usually one or two business days. Since it is unknown whether the specific check will in fact be paid, any such grant of credit must be provisional and may be revoked if the item is returned unpaid. After receiving the check, the payor bank is required by the Uniform Commercial Code either to pay it or to return it unpaid by midnight of the day following the day it receives the check. If the payor bank decides to pay the check, it does nothing and permits the midnight deadline to pass. If the payor bank decides to dishonor the check, it must return it to the depositary bank. As a result, the depositary bank is never notified that a check is "good", it is only notified of "bad" checks.

Due to the uncertainty of whether it will receive final credit, the depositary bank may be, in effect, making a loan to the depositor if it allows the depositor to withdraw funds at the same time that the bank receives provisional credit. In this situation, the bank is at risk that the item will be returned unpaid and that the provisional credit will be revoked. If this occurs, the bank may be unable to recover the funds withdrawn by the depositor.

While the forward check collection process is relatively fast, The return process is manual and considerably slower. For a returned check, each endorsement stamp on the back of the check must be read to determine to which bank or institution the check must next be returned. Each bank in the return process dispatches a returned check to the next succeeding bank by midnight of the next business day following the day of receipt. Often the institution merely places the check in the mail by the midnight deadline. Accordingly, the return process is considerably longer and much less predictable than the forward process. In addition, a majority of thrift institutions clear checks though commercial banks. As a result, the clearing process for them is usually a day or two longer.

Reasons For Delayed Funds Availability

More than ninety-nine percent of all checks are paid upon presentation. It is the less than one percent that are not paid that require banks to place holds on the proceeds of some items in order to protect themselves. If banks were not

permitted to place holds, or unreasonably restricted as to the length of such holds, they would be open to substantial losses from fraud and ordinary credit risk from funds advanced on items subsequently returned. The only way a depository institution can protect itself fully against fraud or credit loss on a particular item is to allow the depositor to withdraw only against collected funds. Due to the delay involved in learning of the return, hold times to protect the bank and its customers may be lengthy.

Critics of bank hold policies frequently argue that the relative insignificance of bad check losses as a percentage of total dollars cleared shows that most holds are either unnecessary or too long. Although bad check losses are a small percentage of the total dollars cleared, the absolute numbers are not small. In a letter to Senator Garn last year, the New York Clearing House reported that out of the 350 million checks returned each year, 140 million checks are returned unpaid the second time. The letter then indicated that in 1985 the average amount of a returned check was $869.00 and it estimated that the total dollar amount of twice-bounced checks in 1985 was $121.7 billion (140 million X $869). Even assuming only a conservative 1% loss rate on twice-bounced checks, $1.2 billion is a great deal of money.

At Wells Fargo, we calculated that over the three-year period of 1983-85 we lost an average of $2.1 million annually on "bad" checks which we could have averted if we had chosen to place holds when the items in question were deposited. Those losses accounted for approximately 20% of total annual losses attributable to operations. Although we hold only about three one-hundreds (.03) percent of the items we process, we would rather incur these losses than aggravate our good customers with a more aggressive hold policy. The losses, however, obviously are not insignificant.

Moreover, the length of a particular hold is a function of how long it takes the payment system to return a dishonored item to the bank of original deposit. Unfortunately making such a determination is not an exact science. If the hold is released before the "bounced" item returns, it is a pointless exercise. In short, a hold placed on the availability of funds represented by a particular deposit - perceived as risky - must be of sufficient duration to afford actual protection. This necessarily results in holds which are longer than necessary in many cases to accommodate the high degree of uncertainty with respect to any particular item.

Most critics largely ignore or discount the deterrent value of hold policies generally. Although there is no empirical evidence on this point of which we are aware, common sense suggests that the check kiters and fraud artists would have increased incentives to engage in illegal activity if holds were never placed or, as would be the case under many legislative proposals, the maximum permissible hold periods were inherently inadequate in certain circumstances. Undoubtedly, bad check losses would be higher in the absence of hold policies.

S. 344: "Fair Deposit Availability Act of 1987"

The CBA has stated previously that this proposal does contain certain features that we believe are essential if any federal legislation is enacted. Today, however, we would like to discuss our continuing concerns as they directly relate to the bill.

Section 5 - Expedited Funds Availability Rulemaking

Section 5 provides two alternative methods for determining a schedule for funds availability. The first approach requires that the Federal Reserve Board (Board) improve the check clearing system and promulgate a schedule within four years of enactment of this legislation. Under the improved system, a financial institution should reasonably expect to learn of the non-payment of any item within four (possibly five) intervening days between the day of deposit and the day the funds are available. This extremely tight availability schedule would be promulgated only if the return system is effectively improved to this extent. Since the costs of implementing these changes is unknown at this time, we appreciate the language in Section 5(b)(2) that requires the Board to balance the costs and benefits of any improvements.

The California and New York statutes delegate the schedule-setting authority to state banking regulators in a similar manner - however, the specific time frames were not established by statute. The regulators have had the necessary authority to balance expedited availability with safety and soundness concerns. If there is to be a mandated schedule, we believe that it is essential that the Board be given similar flexibility to determine its contents. Furthermore, it is even more important that the schedule be tied to improvements to the return system so that banks are not placed at risk.

As you review Section 5 of S. 344, we would ask that you also consider the following amendments:

- o permit the Board additional flexibility in case the system is considerably improved but not to the extent that four or five days is realistic;

- o require that the Expedited Funds Availability Council, established pursuant to Section 5(a), or another appropriate body, be assigned the responsibility of independently validating whether the Board has made the requisite progress and reached its ultimate goal of reasonably improving the system; and

- o clarify that the 4 intervening days (Section 5(b)(1)) between deposit and availability under the improved system refers to 4 intervening business days. This revision would recognize that there are times such as weekends and holidays when institutions are not open for business.

The second alternative proposed by Section 5(c)(1) of this legislation provides that, in lieu of improving the return system, the Board may promulgate regulations limiting the length of check holds "... based upon the number of days necessary to provide provisional credit." If this alternative is used, the Board then has the authority to establish, by regulation, a list of exceptions to the provisional credit time limitations.

We are especially concerned about this alternative.

Provisional credit is determined by the check forwarding process only. It does not consider whether or not the item is collectible or how long it takes for the item to be returned. Provisional credit is generally granted within two days of deposit. Under this schedule, it appears that if a customer deposited a check on Monday and the bank received provisional credit within two days, the funds would almost always to be available by Wednesday. Although the regulation permits exceptions to the schedule, it offers inadequate protection to financial institutions and if adopted could encourage fraud because it does not require the Board to improve the return system. At the very least, it will cause depository institutions to accept a greater number of items on a "collection" basis only, with the attendant fees, delays, and loss of interest credit associated with that totally manual process. If the Board cannot improve the return system, may we suggest that an alternative mirror the California and New York approach which more closely acknowledges the actual availability and processing times. The practices in these states have proven satisfactory to consumers and relatively safe for financial institutions. Moreover, the time can be shortened later if the return system is improved.

In addition, the legislation requires that the Board "may" establish these exceptions. We ask that the Board be required to establish exceptions and that it be given the authority to include additional exceptions that it deems necessary.

While we appreciate the option of alternative solutions, we believe that the most effective solution is one that mandates improvements to the return system and not one based solely on the time frame for provisional credit. A system based on an improved return system, however, should also include a more flexible exception provision to cover any areas that the improvements may not be able to address.

Section 10 - Effect on Check Acceptance Policies and Other Laws

Section 10(b) allows state law to override the provisions of the proposal if state law requires funds to be available in a shorter period of time. Section 10(c) generally supersedes other provisions of state law "which the Board determines to be inconsistent with the provisions of this Act...." The preemption standard may be inadequate because of the considerable potential for complex and confusing disclosures, as well as good faith misapplications of overlapping laws. Further, reconciling the differences may be impossible. For example, under S. 344, the Board has the authority to define local and non-local items. Currently, California and New York regulations have very different definitions of these terms.

For example, in California, the distinction between local and non-local items is actually a rather complex system based on whether (a) both the depository and payor institutions have the same Los Angeles or San Francisco Federal Reserve Routing numbers, (b) only one institution bears such a designation or (c) neither does. In New York, the distinction is based on whether the institution is located in the same geographical area and uses the same clearing facility as the depositary bank. (These same concepts proved unworkable in the California environment.) As a result, these definitions encompass different areas and therefore different items. Further, the respective laws mandate different availability schedules for these items. Without one standard, it would be extraordinarily difficult to decide how an item should be handled and at what time the funds should be made available. The attendant disclosures could also be confusing and unnecessarily complex.

Moreover, under Section 5(b)(1) the schedules are predicated on changes in the return system. The Board must improve the return system so financial institutions can reasonably expect to learn of the non-payment of any item within four or five days. If, under, Section 10(b), state laws with shorter time schedules are permitted to supersede federal schedules without any consideration of the actual time involved in return process, the well-thought-out rationale and necessity for improving the return process are negated.

We acknowledge the arguments against a comprehensive preemption. Consumer representatives want consumers to benefit from the shortest availability schedules. The right of every state to regulate its affairs is also of paramount importance. At the same time, financial institutions do not want to face increased risks and near insurmountable disclosure and compliance burdens. There are merits to each argument but we are addressing changes to a *nationwide* payments system. We respectfully ask that serious review and revision be made of any preemption standard that is included in this legislation with a view toward total federal preemption.

In addition to the paramount issues that we have already addressed, we would like to comment on some of the other important provisions of the proposal under consideration.

Scope

The definition of "deposit account" in Section 2(3) includes consumer and commercial accounts. The legislation should be limited to consumers. Commercial entities generally negotiate their extensive and sophisticated banking relationship with financial institutions and the time frame for funds availability is often a component of the negotiations. In addition, we are unaware of any widespread availability problems in the business community and including business accounts within the scope of the bill could increase compliance costs.

Furthermore, the goal of the S. 344 is to "provide timely access to funds deposited by checks." Yet it does not include all institutions, such as firms that offer money market funds with check access. Many consumers access these accounts by check and we ask that the legislation include all entities that provide check or check-like transactional account services.

Disclosure

Section 3(a) would require that a written disclosure of an institution's *specific* funds availability policy be provided before the account is opened whereas Section 3(b)(1) would require posting of a *general* policy at each location where employees receive deposits. We ask that you permit the Board to determine when a *specific* versus a *general* policy be provided. Some institutions provide a description of their general policies in their comprehensive disclosure materials. If disclosing *specific* policies were required, the entire pamphlet would have to be changed any time a specific fact was changed. In addition, consumers may be more likely to care about specific hold periods at the time they actually deposit funds, and a specific policy disclosure may be more appropriate in the lobby.

Section 3(e) would require each depository institution to provide disclosure of its *specific* availability policy upon the telephone request "of any person." This subsection is unclear and creates a potential operational and customer relations problem. First, is an oral disclosure by telephone required in response to a telephone request or does this subsection permit the furnishing of the institution's written

Senator SHELBY. Thank you, Mr. Wilhelm.
Mr. Monks.

STATEMENT OF DONALD R. MONKS, EXECUTIVE VICE PRESIDENT, IRVING TRUST CO., NEW YORK, NY, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MONKS. Senator Shelby and members of the subcommittee, my name is Donald Monks. I'm an executive vice president of the Irving Trust Co. in New York. I serve as the chairman of the operations and automation committee of the American Bankers Association and I offer testimony today on behalf of the association with regard to the Fair Deposit Availability Act of 1987.

Senator Shelby, we view the approach taken in S. 344 as a conceptual breakthrough in the logjam of debate which has existed with regard to the issue of funds availability.

The legislation has fairly attempted to establish a balance between the customer's demands for guaranteed access to the funds on deposit with banks and the risks accepted by financial institutions in providing that speedy access.

We agree with four basic underlying concepts within the bill. Customers must receive clear disclosure concerning policies that the bank has with regard to deposit funds availability.

Second, that regulatory authority must be provided to the Federal Reserve to improve the check processing system, and I must add, not just the system as it appears in the public sector within the Federal Reserve but the entire check clearing system.

Third, that the availability schedules be linked to improvements in the return item process.

And finally, that the Federal Reserve have some flexibility in implementing the schedules.

Although we do have some concerns with specific provisions, we do commend the committee for advancing a constructive approach on this long debated issue.

The expedited funds availability section is the heart of the bill. It appears to offer reasonable alternatives to rigid mandated schedules, in the first option by providing regulatory authority to the Federal Reserve to improve the system and to thereby work under a set of maximum schedule arrangements; and a second option by providing established availability schedules based on provisional credit with an exception list.

RETURN ITEM PROCESS IS A REAL PROBLEM

The approach in the first option is certainly the one we prefer. It addresses the real cause of the problems in the check clearing system. That is, that it takes too long to return a check in the return item process. The ABA has worked with the Federal Reserve over the years, albeit on some schemes which have not proven to be effective. We do feel that we have come to terms from a procedural standpoint with the improvements that are needed. The improvements needed are specific regulatory authority with the Federal Reserve, through regulation, to override constraints within the uniform commercial code and certain States that prevent creative approaches to expediting the return of checks in the system.

This is clearly a strength of this bill. For the first time, it provides the authority required not only to try and improve the check clearing system but to allow the Fed to mandate improvements to the check clearing system. Any compromise, any changes in this bill that allow change to that element of the bill are clearly going to make option 1 unworkable in any way. If we do not improve the return item process within the check system, we do not have the proper balance between improved availability and thus fair access and minimization of risks on the part of the banks.

We do have serious concerns about the second option and would hope that we do not have to default to that option. We believe that improvements in the check system are possible. The overwhelming danger in the second option is clearly that when credit is given on a provisional basis it encourages scheming and fraudulent activity such as check kiting. That has been spoken well of here today by other witnesses and I won't go into that, but we feel this is a real concern.

As we've discussed in our prepared statement, the strength of the approach in the first option is that it addresses the cause of the check holds; that is, the processing system that requires too long a period between the dishonor of a check and the return to the depositing institution. We believe that this bill provides the critical authority required by the Fed to make the required changes in the existing law and to provide the return items the most expeditious, not the current scheme which is defined in many instances in the uniform commercial code; that is, return to the bank of first deposit.

Thank you, Mr. Chairman, for allowing me to comment.

[The complete prepared statement of Donald R. Monks follows:]

policy by mail? Second, should institutions be required to provide this rather expensive service (dedicated phone line and trained personnel) to answer questions from people who are not customers? Third, if civil liability can be imposed for failure to comply with this requirement, are recorded conversations contemplated so as to prove whether compliance has occurred? Fourth, if someone inquires generally about the institution's policy, must the entire policy be explained in detail to them? Fifth, if a specific question is asked based upon the customer's disclosure of only the facts he or she deems relevant, an oral answer may prove to be misleading when, at the time of deposit, it is discovered that the item is defective, the customer is very new or the account has been badly handled (i.e., repeated overdrafts). Most institutions are happy to answer specific questions or mail appropriate disclosures when they receive calls from customers. But it may be a mistake to impose a whole new layer of compliance and liability for something so fraught with misunderstanding if conveyed orally.

Section 5(e)(1) requires immediate notice of the reason for a hold when a consumer makes a deposit in person. Though Section 5(e)(1)(A) permits an institution to mail a notice when "facts giving rise (to the exception) occur after receipt," the immediate notice requirement presents problems. In many instances, the essential information (such as a history of overdrawn checks) may not be operationally available until after the consumer has left the bank premises. It appears that the exception to immediate disclosure 5(e)(1)(A) does not apply because the "fact" of the customer's history did not arise at that time, rather, the institution realized the information after the customer departed. We would ask that the "exception" language be clarified to include those instances when the institution learns that a hold is applicable after the customer has left.

In addition, the decision of whether there is a hold period and the reason for the hold may not be made by the teller. If there are a number of customers waiting in line for the teller, an immediate notice requirement will lengthen their waiting time and aggravate customers. Moreover, if the teller does have the authority to immediately decide and inform a customer why a check is being held, the customer may not appreciate that the information (i.e., a history of overdrawn and unpaid checks) is discussed so publicly. At Wells Fargo, the notice for uncollected funds (see Appendix A) is of a more general nature and we respectfully ask that you consider revising this provision.

Section 5(c)(2)(B) permits the Board to establish an exception "for large dollar deposits by check or similar instrument in any day." It is appropriate that the Board have greater latitude in defining this exception because different institutions have developed different approaches depending on their experience and operating environment. The California and New York regulations are examples of different approaches.

In California, an entire check is exempt from the hold period if the item is drawn in the amount of $2500 or more. In New York, the deposits are aggregated, and if the amount of deposits in any one day exceeds $2500, then the institution can exempt the excess over $2500 from the hold period. The different approaches recognize the different operations in the two states. The words "in any one day" of Section 5(c)(2)(B) appear to establish the exception only for an aggregate policy similar to New York's. We ask that you delete those words to permit the Board more flexibility.

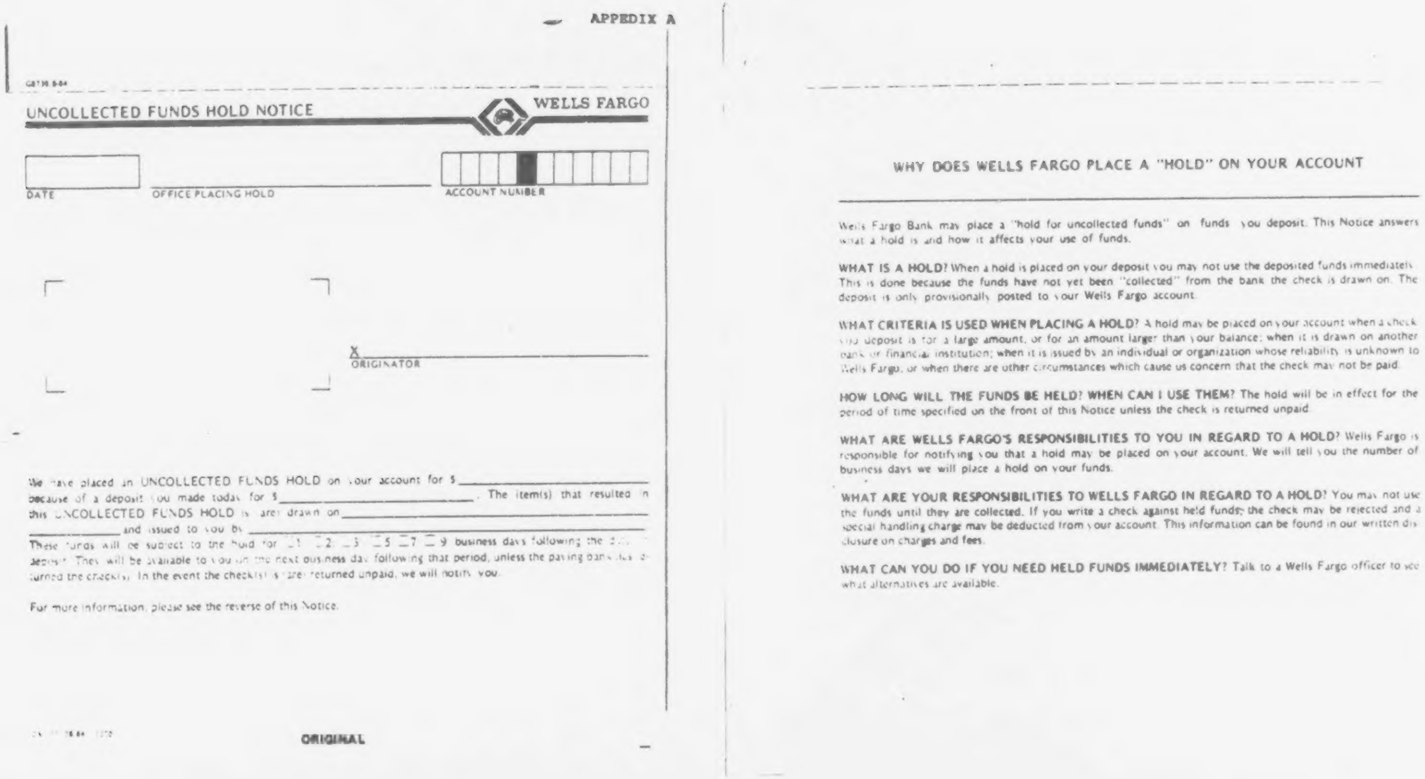
Conclusion

In recent years financial institutions have made tremendous strides in the area of funds availability. A majority of institutions have adopted reasonable policies and disclose these policies to their customers. Many place holds only in special circumstances. If Congress, however, believes that it is necessary to enact legislation, we respectfully request that it include at least the following concepts:

- An availability schedule that is promulgated by the appropriate federal regulatory agency and predicated on improvements to the return system (balancing costs to institutions and benefits to customers) so that the schedule and knowledge of the "collectibility" of an item are synchronized;
- Exceptions to the schedule that are extensive and flexible enough to ensure that the financial institution does not assume unnecessary risks due to fraud, insolvency, lack of experience or bad experiences with customers or circumstances beyond its control; and
- A federal preemption standard that will ensure uniformity in the national payment system.

In today's very competitive consumer financial services environment, it is in the best interest of financial institutions to provide products and services that attract and keep customers. The safety and efficiency of the payment system, however, must be a paramount consideration. To this end, the Consumer Bankers Association welcomes the opportunity to provide information or assistance on the issue.

APPEDIX A



[illegible]

UNCOLLECTED FUNDS HOLD NOTICE

WELLS FARGO

DATE

OFFICE PLACING HOLD

ACCOUNT NUMBER

X____________________

ORIGINATOR

We have placed an UNCOLLECTED FUNDS HOLD on your account for $__________ because of a deposit you made today for $__________. The item(s) that resulted in this UNCOLLECTED FUNDS HOLD is (are) drawn on __________ __________ and issued to you by __________ These funds will be subject to the hold for ☐ 1 ☐ 2 ☐ 3 ☐ 5 ☐ 7 ☐ 9 business days following the date of deposit. They will be available to you on the next business day following that period, unless the paying bank has returned the check(s). In the event the check(s) is (are) returned unpaid, we will notify you.

For more information, please see the reverse of this Notice.

[illegible]

ORIGINAL

WHY DOES WELLS FARGO PLACE A "HOLD" ON YOUR ACCOUNT

Wells Fargo Bank may place a "hold for uncollected funds" on funds you deposit. This Notice answers what a hold is and how it affects your use of funds.

WHAT IS A HOLD? When a hold is placed on your deposit you may not use the deposited funds immediately. This is done because the funds have not yet been "collected" from the bank the check is drawn on. The deposit is only provisionally posted to your Wells Fargo account.

WHAT CRITERIA IS USED WHEN PLACING A HOLD? A hold may be placed on your account when a check you deposit is for a large amount, or for an amount larger than your balance; when it is drawn on another bank or financial institution; when it is issued by an individual or organization whose reliability is unknown to Wells Fargo, or when there are other circumstances which cause us concern that the check may not be paid.

HOW LONG WILL THE FUNDS BE HELD? WHEN CAN I USE THEM? The hold will be in effect for the period of time specified on the front of this Notice unless the check is returned unpaid.

WHAT ARE WELLS FARGO'S RESPONSIBILITIES TO YOU IN REGARD TO A HOLD? Wells Fargo is responsible for notifying you that a hold may be placed on your account. We will tell you the number of business days we will place a hold on your funds.

WHAT ARE YOUR RESPONSIBILITIES TO WELLS FARGO IN REGARD TO A HOLD? You may not use the funds until they are collected. If you write a check against held funds, the check may be rejected and a special handling charge may be deducted from your account. This information can be found in our written disclosure on charges and fees.

WHAT CAN YOU DO IF YOU NEED HELD FUNDS IMMEDIATELY? Talk to a Wells Fargo officer to see what alternatives are available.

TESTIMONY OF THE
AMERICAN BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON CONSUMER AFFAIRS
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
ON S.344

FEBRUARY 5, 1987

Mr. Chairman and members of the Subcommittee, my name is Donald R. Monks, Executive Vice President of the Irving Trust Company in New York. I serve as Chairman of the Operations and Automation Division of the American Bankers Association, and in that capacity offer testimony today on behalf of the Association. I am here to discuss the Association's position on S.344, the Fair Deposit Availability Act of 1987.

Mr. Chairman, we view the approach taken in S.344 as a conceptual break-through in the logjam of debate on the issue of funds availability. The legislation has attempted to establish a fair balance between our customers' demands for guaranteed access to funds on deposit and the risks accepted by depository institutions in providing that access. We agree with the basic concepts underlying S.344, in that:

(1) Customers receive clear disclosure concerning policies with respect to deposited funds availability.

(2) Regulatory authority is provided to improve the check collection and return process.

(3) Availability schedules are linked to improvements in the return process within a maximum hold period.

(4) The Federal Reserve has flexibility in defining schedules and exceptions.

Although we have concerns with some provisions contained in S.344, we commend the Chairman for advancing a constructive approach to resolve this long debated issue. This statement is designed to discuss the following:

- Realities of funds availability;
- Developments in the Payments System;
- Comment on key provisions of S.344;
- Summary and conclusions

REALITIES OF FUNDS AVAILABILITY

Any discussion of funds availability must consider the realities of the check processing system, the fact that some checks are indeed returned unpaid, and the risks associated with making funds available without knowing whether or not the checks will be paid finally.

Any legislative effort to address funds availability must be undertaken keeping in mind the actual magnitude of the problem, the risks of any such proposal, and the legitimate interest of the banking industry itself in developing and implementing solutions which maintain the safety and soundness of the payments system and the trust and confidence of our customers.

The check payments system relies on the physical movement of paper to order funds transferred from an account in one institution to an account in another. In order to accommodate this paper movement, a complicated system involving correspondent banks, the Federal Reserve, and check clearing houses has developed. This process is discussed in detail in the Attachment following this statement, and is summarized briefly in the next few paragraphs.

A check is not cash. It is an order to a bank to pay cash to the person who is the payee of the check. Until that piece of paper arrives at the bank on which it is drawn, no one is sure whether it will be honored as valid or returned unpaid for any of a variety of reasons. Given the volume of checks processed on a daily basis in this country (over 100 million), there is no positive notice that a check has been paid. The only notice the bank of first deposit has that a check is bad is when it is returned unpaid. It is this uncertainty which leads banks to place selective holds on deposited funds.

A check may have to pass through several institutions and over thousands of miles before finally reaching the bank on which it is drawn. This forward passage, although it may involve numerous steps, is relatively efficient due to automation and magnetic encryption of checks. The return process, however, takes much longer. If the check is dishonored by the payor bank, the check must retrace its steps through the chain until it reaches the bank of first deposit. The return trip is not assisted by automation; it requires that each participating institution review the check manually to credit and debit accounts appropriately and to decipher from the puzzle of endorsement stamps on the back of the check the next institution in the chain before sending it back to that institution.

The return process is further delayed by the "midnight deadline" rule. Article 4 of the Uniform Commercial Code (UCC) governs check collections in each of the 50 states. The UCC requires that when a bank dishonors a check, it must return the check to the bank in the chain which originally sent it to the dishonoring bank, by midnight of the day after the dishonoring bank received it. Each intermediary bank in the chain has the same midnight deadline to send the dishonored check back to the bank from

which it received it. The surest and safest way to "send" the check and assure compliance with the law is to put the dishonored check in the mail. The law deems the check "sent" if it is in the mail and out of the control of the dishonoring bank. Sending the check in the mail to each intermediary bank in the chain obviously takes considerable time.

Although the time required to process a check drawn on good funds is comparatively brief, the time to process a dishonored check is unfortunately lengthy. A bank does not receive affirmative notice that a check is "good"; if the check is not returned after a period long enough to accommodate the return check process, the bank assumes that the check was paid. Therefore, a bank with a reasonable basis for imposing a hold must delay access to the funds until sufficient time has passed to allow the check to be returned if dishonored. A hold that is one day too short is of no value.

Generally, our opposition to earlier efforts in funds availability legislation has been based on our objection to a Draconian approach which ignored the realities of the check processing system and failed to address adequately the risks involved in eliminating a bank's ability to hold checks selectively. Some legislative approaches have mandated specific funds availability schedules that had little relationship to the realities of the check processing system. These approaches imposed unfair levels of risk on banks. The legislative solution needs to recognize the limitations of the check processing system, and avoid undue risks for the banks.

DEVELOPMENTS IN THE PAYMENTS SYSTEM

We operate in a highly competitive marketplace comprised of some 15,000 commercial banks, 3,500 savings and loan associations, 18,000 credit unions, 400 savings banks, and an ever increasing array of other participants in the financial services marketplace, all competing for the consumer's business. Customer service and confidence in our institutions are key ingredients for success in a business built upon mutual trust.

Abuse of customers and erosion of confidence and trust are disastrous to our ability to compete in the marketplace. Although specific instances of apparent abuse of funds availability practices can be cited, by and large, commercial banks are reasonable and prudent in the use of check hold practices, and in the vast majority of cases, funds are available to depositors without the imposition of a hold.

Over the past several years, our Association has undertaken a concerted effort to make sure our customers are aware not only of the hold policies and practices at our individual institutions, but also of alternatives to avoid the inconvenience a hold on a critical deposit may produce. We have developed model disclosure forms and policy statements for our members to use. The disclosure statement alerts our customers to the situations where a hold may be placed, and encourages customers to talk to a bank officer with any questions regarding the policy.

The vast majority of our members provide notice of their hold policy when the account is opened. Over sixty percent provide notice by the teller when a hold is placed. Other methods of notification in widespread use include lobby notices and the use of statement stuffers. Given the reality of the financial services marketplace today, we cannot afford to irritate or confuse our customers. The market dictates that we be aware of their concerns, inform them of policies that affect them, and be flexible enough to accommodate their needs.

There are, of course, ways to transfer funds very quickly. For many years, a customer has had the option to "wire" funds on deposit to another institution for any specific purpose. For example, parents of college students use this wire transfer capability to satisfy that urgent request to "send money." The development over the past several years of electronic banking and the automated clearing house for the rapid clearing of electronic payments has given banking a broad new ability to effect very rapid and positive transfers of funds. Currently, over a billion transactions are processed annually through automated clearing houses. In addition, approximately four billion transactions are completed at automatic teller machines. The key advantage to electronic banking is that it is so fast and is not subject to the delayed availability problem.

Over the years, the consumer has typically used the check as a means to obtain cash or as a medium of payment for goods and services. Anyone who has attempted to negotiate a personal check for goods or services is aware of the identification procedures that most merchants require to accept a check. These procedures exist because significant numbers of checks are returned unpaid.

The banking industry, recognizing some of the inherent limitations of the paper-based check system has, with the advent of electronic technology, moved toward alternatives which will offer convenience never attainable with a check.

There are currently over 70,000 automatic teller machines in operation in this country. In the past few years, numerous regional and national systems have developed which electronically link these machines. These shared systems allow the consumer to use his own bank ATM card to get cash from any of a number of machines owned by various financial institutions throughout the region, state, or nation. These systems will expand that availability and convenience geographically. It is already possible to make a coast to coast cash withdrawal which takes only a matter of seconds to process. These systems allow ready access to cash to avoid the hassle attendant to presenting a check for payment.

Similarly, there has been a move to point-of-sale terminals in retail establishments. These terminals use the customer's ATM card to transfer instantly the amount of the purchase from the customer's bank account to that of the merchant without any cash ever changing hands. In each of these cases, the validity of the card, user, and the account balance can be verified electronically and the transfer effected immediately, thus eliminating the delay and uncertainty of a check.

COMMENTS ON KEY PROVISIONS CONTAINED OF S.344

Our comments on key provisions of S.344 are based on a preliminary understanding of the bill without the benefit of extensive discussions with the industry or Committee staff. We hope our understanding of these provisions matches their intent.

o Scope of Coverage

The bill covers customers who maintain accounts at federally insured financial institutions. Since the late 1970's, several hundred money market funds have appeared in the marketplace. These funds hold over 175 billion dollars in over 12 million accounts, most of which have transaction capability similar to a checking account. Yet under the bill as proposed, these consumers would not be covered by the bill.

To protect all users of checks and check-like instruments, it would only seem fair and equitable that any such legislation should be applicable to all financial service providers who offer check or check-like services.

Additionally, we are puzzled by the apparent exemption for foreign bank branches in the United States.

o Limitation to Consumer Accounts

The bill appears to cover all depository transaction accounts, both business and consumer. Coverage should be limited to consumer accounts — primarily for personal, family or household use.

The justification for restricting the legislation to consumer accounts is the significant difference between the consumer/financial institution relationship and the business/financial institution relationship. Unlike the consumer, a business typically uses a wide range of services and has a continuing relationship and often daily contact with the banker. Businesses generally have comprehensive fee and service arrangements with their financial institutions and funds availability schedules are frequently an element of the negotiated agreement between the parties.

o Disclosure

Customers must receive written disclosures of specific availability policies before opening an account; if the account was opened before the effective date of the Act, disclosures must be included in the first regularly scheduled mailing, or at least within 90 days of the effective date. Banks must post general availability policies at locations where employees receive deposits and brief reminders must be available at ATM's. Any changes in funds availability policy may be effective only after notice has been provided, unless the change expedites availability. Information on specific funds availability must be available upon telephone request. Finally, special disclosure requirements apply when interest is not computed on interest bearing accounts by the date of provisional credit.

These disclosure requirements reflect current banking practice generally. However, the telephone disclosure requirement will be a costly burden for many community banks, and we believe that the annual "brief reminder" is redundant in the context of the disclosures already required.

o Interest on Deposits

Institutions are required to begin computing interest on check deposits to interest-bearing accounts when they receive provisional credit, except when an institution computes interest at a date later than provisional credit for all deposits, whether cash or check.

It has been the practice for most banks to accrue interest for deposits to interest-bearing accounts as soon as provisional credit is received.

o Expedited Funds Availability

Within 48 months from enactment of the bill, the Board must promulgate regulations to expedite customer access to funds deposited by check. The Board may achieve this in one of two ways:

1) The Board may improve the check processing system so that institutions may learn of a dishonor within a statutory time limit, or

2) the Board may establish availability schedules based on provisional credit, with exceptions to the schedule permitted for classes of high risk checks.

Under the first option, no more than four intervening days are allowed between the day of deposit and day of availability. The Board may extend this schedule by one day. If improvements to the system cannot accommodate

such a schedule, the Board would implement a second option which imposes an availability schedule based on when the bank receives provisional credit. The Board has the discretion to establish reasonable exceptions to the schedule for new accounts, large dollar deposits, checks returned unpaid and redeposited, accounts which have repeatedly been overdrawn, foreign checks, and any class of transaction the Board determines poses serious risk of loss if an exception would substantially reduce such risk. In addition, the bill provides that the schedules do not apply where an institution has a reasonable suspicion to believe the checks are uncollectible or in cases of situations and emergencies beyond the control of the institution.

In any case where these exceptions are made, the institution must provide immediate notice of the hold if the deposit is made in person. In the case of any other deposit, the institution must mail the notice by the close of the next business day. Where an institution imposes a hold based on knowledge it receives after the deposit, the institution must mail notice as soon as practicable.

This expedited funds availability section is the heart of S.344 and it appears to offer a reasonable alternative to rigid mandated schedules. Specifically, the bill requires the Federal Reserve Board to promulgate regulations to expedite customer access to funds deposited by check, either in the case of the first option by improving the check processing system so that depository institutions reasonably know whether a check has been dishonored within a specified period, or in the second option by establishing availability schedules based on when a bank receives provisional credit. We prefer the first option because it appears to offer a workable solution in a rational time frame.

Importantly, the bill gives the necessary teeth to the provision to improve the system by granting the Board the appropriate regulatory power to overcome present restrictions in the Uniform Commercial Code and state laws.

The strength of the approach in the first option is that it addresses the real cause for check holds, i.e., a check processing system that requires too long a period to return a dishonored check. Clearly, a check hold need only be as long as the time required to process an unpaid item; the shorter the processing time, the shorter the hold necessary to protect the bank against loss. ABA has worked with the Federal Reserve toward an improved and more efficient return system, and supports this approach.

This option can be practical and workable. The Federal Reserve's recent pilot return check program has shown great promise in shortening the return check process. The greatest obstacle to its ultimate implementation and success has been the Board's lack of authority to require that all checks, whether or not they clear through the Federal Reserve System, be subject to the pilot return process. S.344 empowers the Board to override any state law, including the Uniform Commercial Code, which the Board determines to be inconsistent with the Act.

One reservation about this option to improve the system concerns the maximum time limits in which the system must allow banks to learn of a check's collectibility. The bill requires that the system allow no more than four (with an optional five) intervening days to pass between the day of deposit and the day of availability. With this restriction, it is possible that the pilot program could be discarded merely because its return time is one day too long. The consequence of failing to improve the system adequately to conform with the statute's maximum time limits is implementation of the second option: an availability schedule based on provisional credit, rather than one based on actual processing time.

The provisional credit alternative contained in the second option poses significantly more risks to banks than a schedule based on an improved return item system. The bill should not be structured so rigidly as to default on a viable solution to the current return item process by imposing an arbitrary maximum hold period. A solution may be to empower the Federal Reserve to expand the four day intervening maximum on a temporary basis, until system improvements match the bill's mandate.

We have serious problems with the bill's second option alternative which we understand to become operable should the Board fail to improve sufficiently the check processing system to make the first option work. The Board's alternative under the second option is to impose availability schedules based on provisional credit. Under this provisional credit availability approach, banks are permitted to hold checks which fall under the high risk categories designated in the bill or when they have a "reasonable suspicion" to believe that the funds are uncollectible, provided that proper notice is given.

The overwhelming danger with a schedule based on provisional credit is that it encourages check fraud. Under this option, customers will often have access to funds even before the check is presented to the payor bank. Under this scenario, check kiting is quite simple to orchestrate and banks would be placed at an unacceptable risk level.

o Exceptions

Although we object strenuously to the time restrictions of the second alternative available to the Board, the exception classes allowable for the second option are drawn with attention to the realities of the check-writing world.

First, we agree that the classes of exceptions to the availability schedule should not be drawn too specifically by statute. Rather, S.344 lists classes of high risk checks that may be excepted, but grants the Board the discretion to determine the details of these exceptions. This is a better approach than defining arbitrarily by statute the boundaries of each class. The Board is in an informed position to evaluate where the greatest risks exist. We do believe however, that the Board should have the authority to apply these classes of exceptions as needed to the first option. Exceptions are needed for new accounts, high dollar items, foreign checks, and repeatedly overdrawn accounts.

S.344 also includes a valuable exception that allows banks to place holds on checks, in accordance with Board regulations, based on a reasonable suspicion that a check is uncollectible. This exception provides important protection to banks by allowing them to avoid unnecessary risks and loss in situations such as insolvency, fraud, and check kiting.

o Notice

This provision requires that a depository institution give specific notice to its customer if availability for a deposited item will be delayed because the deposit is exempt from the availability schedule. Exceptions to the schedule are made for deposits to new accounts, large dollar deposits in a single day, redeposits of previously dishonored items, deposits to accounts having repeated overdrafts, and deposits of foreign checks. Similar exceptions are made under some state funds availability regulations. However, banks are not required to give specific notice of the exception at the time of the transaction, but may describe the exceptions in a single disclosure statement to customers. Once disclosed, it seems reasonable to expect customers to be aware of exceptions to the availability schedules.

o Expedited Funds Availability Council

The bill creates an "advise and consult" panel representing industry consumers, commercial depositors, technological industries, and the federal agencies.

This Council appears to be redundant to advisory panels already in place, for example, the Consumer Advisory Council and the Federal Financial Institution Examination Council.

o Effect on State Laws

The bill provides that state laws on funds availability shall supercede any federally promulgated law if the state law provides for a shorter period of time in gaining access to the account. State laws should not preempt federal laws in funds availability because such a payments system is a national system. The national approach should, therefore, take precedent over any system established by the individual states regardless of the contents of the state laws or regulations. Any consumer protection legislation relating to individual accounts should apply equally to all consumers and should not be determined by the state in which the consumer happens to live and or do banking.

SUMMARY AND CONCLUSIONS

Over the past several years, our Association has undertaken a concerted effort to make sure our customers are aware not only of the hold policies and practices at our individual institutions, but also of alternatives like wire transfers to avoid the inconvenience a hold on a critical deposit may produce. We have developed model disclosure forms and policy statements for our members to use. The disclosure statement alerts our customers to the situations where a hold may be placed, and encourages customers to talk to a bank officer about any questions regarding the policy. The vast majority of our members provide notice of their hold policy when the account is opened. Over sixty percent provide notice by the teller when a hold is placed. Other methods of notification in widespread use include lobby notices and the use of statement stuffers.

The industry has also expended considerable resources directed at improving and expediting the return process of a dishonored check. An ABA/FRB return item experiment was initiated in the Dallas Federal Reserve District attempting to devise a method for expediting the return process. Concepts developed in the Dallas program resulted in a major pilot effort involving 100 financial institutions in four Federal Reserve Districts, testing a new approach to automating return check processing. This pilot uses existing automated check processing technology to return dishonored checks to the institution where they were first deposited, eliminating much of the manual processing. S.344 provides authority to the Federal Reserve to make changes to existing law to accommodate the new return item

processing concept. These changes would allow:

- Federal Reserve to accept all return items.
- Direct return of deposited checks, without following the original chain of endorsement.
- Payor institutions to keep return items past the midnight deadline if that practice would facilitate more rapid return.

Other industry efforts have involved enormous investments in electronic technology. These efforts afford convenient payment and access alternatives never attainable with a check. Annually, billions of transactions are now processed through automated teller machines, point-of-sale terminals, and automated clearing houses.

* * *

As we have discussed in this statement, the strength of the approach in the first option is that it addresses the real cause of check holds, i.e., a processing system that requires too long a period to return a dishonored check. We believe the bill provides the critical authority to make required changes to existing law to sanction the return of items to the bank of first deposit, regulate changes in the handling of all return items - not just those cleared by the Federal Reserve, and eliminate the restrictive effects of the midnight deadline.

Thank you, Mr. Chairman for allowing me to present the views of the American Bankers Association. I would be glad to answer any questions.

Attachment

Checks and the Delayed Availability of Deposited Funds

A check is nothing more than a written order to pay from the owner of an account to the bank where the account is located. The check tells the bank who to pay (the payee) and how much. The signature verifies that the account holder has, in fact, authorized the transfer. In order for the payee to convert the check into hard currency, he needs to take the check to the bank holding the account on which the check is drawn. However, most people when they get a check, rather than go across town, (or across the country) to present the check for payment, take the check instead to their local bank and deposit it (the bank of first deposit). Their local bank takes on the job of getting the check to the bank which holds the account (the payor bank). The process by which the check is moved to the payor bank for collection is a very sophisticated and high speed process.

The check collection system moves about 100 million (100,000,000) checks every day. The system is very efficient in moving checks from the bank of first deposit to the payor bank. This is chiefly because the system is almost totally automated, and typically, after initial processing, a check moves virtually untouched by human hands to the payor institution. Each check has encoded on it in magnetic ink, identification numbers for the payor bank and the particular account at the bank on which it is drawn. The processing equipment in each successive institution that processes the check reads this data and sorts the checks into bundles for shipment to the next processing institution. The bundles of checks are moved from one institution to the next along the collection chain by couriers.

This system works so well that approximately 98 percent of all checks reach the payor institution within three days of deposit, despite the fact that the check may have passed through a network of several commercial and Federal Reserve banks on the way. Once the check reaches the payor bank, it is up to that institution to examine the check to determine its validity and whether there are sufficient funds in the account. The reason for bank hold policies that substantially exceed the forward processing time, is that there could be a problem with the check or the account balance. If the payor bank decides not to pay the check, under current procedures the check is returned to the bank of first deposit through the same chain of banks which processed it on the forward route. Unfortunately, the check processing system that operates under current procedures and legal constraints is not nearly as efficient going backwards as it is going forward.

The attached illustration explains the number of institutions that may actually process a check before it reaches the payor bank. As the check moves on its forward path, each institution gives the prior institution provisional credit for the item. For example, when the bank of first deposit sends the check to is correspondent, the correspondent will give the first depository bank a credit in a special account which the first depository bank maintains with the correspondent. The credit, however, is provisional and subject to cancellation if the payor bank ultimately dishonors the check. This provisional crediting continues along each step of the way until the check reaches the payor bank. Under the Uniform Commercial Code, the law which governs check collections, the payor bank having given provisional credit for the item, has until midnight of the next business day to dishonor the item and revoke the provisional credit. If it does nothing, the credit is made final and all of the provisional credits in the chain are final. In short, the bank is stuck with the check.

The transportation and processing of checks operates on a 24 hour cycle. The evening hours are the logical time to collect and distribute the checks generated during the business day. During this time period, the checks are physically moved among Federal Reserve Districts and among banks within the districts. A correspondent bank may receive checks drawn on a number of its respondent banks or other banks in addition to checks drawn on it. (A check drawn on a bank is called an "on-us" item by that bank because from the bank's perspective, it is drawn "on-us". Conversely, if the check is drawn on another bank and the correspondent is merely processing it, it is a non-on-us item). The initial sort by the correspondent separates the checks going elsewhere from the "on-us" checks.

In the morning, the "on-us" checks are received from the Federal Reserve and/or local clearing house and are processed along with the growing flow of items received through that banking day from the various offices of the bank (i.e., consumer and merchant deposits; cashed checks, etc.). By evening, the cycle is beginning again. The "non-on-us" items received during the day are transported during the evening. Meanwhile, computers are posting the accounts with the information from the morning and afternoon processing. It is not until the following morning that the checks drawn on accounts with insufficient funds are identified. If there are insufficient funds in the account, the bank may wait before dishonoring the check in anticipation of a deposit sometime that day. Therefore, the final decision to dishonor a check many times does not occur until the early evening. The bank must then quickly get the check on its way back to the previous bank to avoid the impact of the midnight deadline. Usually, the only way to get the check out of the bank's control and on its return journey (and thus, avoid the midnight deadline), is to put the check into the mail on its way back to the next prior endorser. As long as the check is in the mail before midnight, it is legally deemed to be "sent", and the dispatching institution is absolved of responsibility for it.

The impact of the Postal Service on the return process should be self explanatory. In addition, the actual check processing of returns is all done manually. On the forward path, each processing bank places its endorsement on the back of the check. On the reverse path, each bank must examine the back of each check to make sure it was an endorsing bank. It must then determine the next prior endorser, adjust its books to remove the provisional credit previously given, and send it on its way. This process can easily take three or four times longer than the forward processing trip.

Under the current system, the bank of first deposit never knows for certain if a check is good. The immense volume of checks processed each day and the vast number of institutions involved in the payments system (around 40,000) make it impossible to give positive notice that each has been paid. The bank of first deposit can only assume that a check was good if enough time passes for the check to get to the payor bank and be returned, without the check actually being returned. The key then to reducing hold periods is to expedite the return process.

The two major problems with the current return process are that (1) it is a manual process, each must be individually examined at each institution along the return processing chain, and (2) the high speed courier system that moves checks forward through the system is virtually useless in the return process due to the midnight deadline and the length of time it takes to manually process returns.

Recognizing the need for change, the Transaction Processing Committee of the American Bankers Association's Operations and Automation Division examined the issue and came up with a suggestion that has resulted in the testing of an experimental return system.

Under this system, the dishonoring payor institution would place the dishonored check in an envelope and encode the envelope in magnetic ink with the institutional identifier of the bank of first deposit and the dollar amount of the check.

Once this is done, the check can be processed back to the institution of first deposit via the existing automated process. In short, the "return item" becomes, as far as the automated processing system is concerned, a forward moving check bound for the institution of first deposit. This system would also result in the by-passing, on the reverse trip, of some of the intermediary banks currently involved in the process. The implementation of such a system on a nationwide basis could substantially reduce the time it takes for a check to make its way back to the bank of first deposit. Implementation would be greatly facilitated since it uses existing technology and equipment.

The initial results of this test are very encouraging, and the Association is committed to assisting the Fed in pursuing accelerated implementation of this innovative new return system.

Illustration of Check Processing System

Preface

For this example, let's follow a hypothetical check drawn on a bank in Connecticut and deposited in a District of Columbia bank. A check moving from the District to Connecticut for collection would pass through many more hands than an intra-state or local check, but will be illustrative of the way the check clearing system operates. The first step is the payee endorses and deposits the Connecticut check in the D.C. Bank.

Local D.C. Bank

The D.C. Bank will accept the check for deposit and provisionally credit the payee's account for the amount of the check. The bank will then encode the check with the dollar amount in magnetic ink on the lower right hand corner and forward it directly to the Federal Reserve Bank of Baltimore or to a correspondent bank, depending on the size of the bank of first deposit.

Local Correspondent Bank

Many smaller banks have relationships with larger regional banks to provide them with check clearing and other services. These so-called correspondent banks may service many such smaller banks. The Correspondent uses its high speed processing equipment to sort the checks it receives into bundles bound for other banks and the local Federal Reserve Bank. The Connecticut bound check would probably end up in the bundle going to the Baltimore Federal Reserve.

The Baltimore Federal Reserve Bank

The Federal Reserve System operates a very sophisticated air and land courier system for many checks between Federal Reserve Districts and between banks within a Federal Reserve District. Since Connecticut is in the 1st Federal Reserve District and is serviced by the Boston Federal Reserve Bank, the Baltimore Fed would bundle the Connecticut check with all the other checks it has received from area banks which are bound for the 1st Federal Reserve District, and send them on to Boston.

Boston Federal Reserve Bank

The Boston Federal Reserve Bank will sort the checks it receives from the Baltimore Fed and bundle them to go out to the various banks in the 1st District. The Connecticut check may go directly to the Connecticut payor bank, or it may go to a correspondent of the Connecticut Bank.

Connecticut Payor Bank

Once in its hands, the payor bank must make a decision to pay or not to pay. In the event that the item is not paid, it must be "sent" back to the next prior endorser by midnight of the next business day.

Senator SHELBY. Thank you.

I'd like to ask all of you one basic question and you all touched on it. Would modernization of the system solve most of the problems? I know you've made steps in the right direction. It's a problem of information, is it not?

Mr. REDEKER. Senator, in the area of disclosure, as you mentioned, information, is critical. I think that appropriate disclosures on the part of banks, on a uniform basis, would go a long way toward solving this problem.

The information aspect of our business can be improved.

Senator SHELBY. Mr. Monks, you've been very active in the American Bankers Association.

NO TECHNOLOGY BREAKTHROUGH ON THE HORIZON

Mr. MONKS. Sir, I've run operations for a major correspondent bank. I've run the national standards committee for Financial Institutions Standards. There is no—absolutely no technology breakthrough on the horizon that can solve this problem.

Senator SHELBY. Despite what others might think?

Mr. MONKS. Yes, sir. I believe that strongly. I've reviewed technology. All roads lead to return of the item to the bank of first deposit expeditiously. That's a procedural change that can be accommodated under the regulation empowered under this bill to the Federal Reserve.

Senator SHELBY. What would the return process, if it were expedited like the initial process—what would that do? Isn't the return process quite lengthy?

Mr. MONKS. In the current climate we've seen that cut down to 6 days, which is not quite what the bill requires, but I think in a mandated environment which we would be in under the Fed being allowed the regulatory—not the persuasive authority—and there's a large difference obviously—that we could reach a system which would be operable within the guidelines of the bill.

Senator SHELBY. Let's go back to technology. Even the most modern technology that you've seen or examined or known about, it wouldn't expedite the system?

Mr. MONKS. Sir, yes, it could, except——

Senator SHELBY. What would it cost to do?

Mr. MONKS. It would cost literally millions of dollars, sir, and I do not think it could be implemented before the year 1995 or beyond in sufficient quantity in this Nation—in other words, covering a sufficient percentage of the checks cleared—to accommodate the revolution which we are going to have in that timeframe I believe of electronic wire transfer which is the ultimate solution to this problem—the presentment of a credit to a customer's account at another bank which is irrevocable upon presentment, not a check which is a right to draw subject to provisional credit, which is really, in a large scheme of a mobile society, which is really the problem that the check system cannot handle the mobilization of our society and that's why it worked 20 years ago and it doesn't work now—it just is not possible to handle the volume of return items, albeit a small percentage—don't forget we clear 100 million checks a day. A half a percent of those checks is a large number of checks being handled on a return basis in an antiquated system. The answer is electronic funds.

Senator SHELBY. But you would concede that we, you, or the Fed could improve the system tremendously?

Mr. MONKS. Yes, sir, procedurally.

Senator SHELBY. And would the returning of the checks help improve the system?

Mr. MONKS. Absolutely, sir.

Senator SHELBY. Is that the slowdown period for the most part now?

Mr. MONKS. Yes, it is. It's not the presentment of the checks. It is the return of the checks and the fact that we follow the rules of law under the Uniform Commercial Code, which are antiquated. They don't support the needs of returning checks by the fastest means.

Senator SHELBY. We could change that, though, couldn't we?

Mr. MONKS. By regulation, sir, yes.

Senator SHELBY. Or legislation.

Mr. MONKS. Yes, obviously.

Mr. WILHELM. Senator Shelby, could I just amplify Mr. Monks' comments about what can be achieved by just the procedural changes that he refers to?

In California today, the overwhelming percentage of checks that are presented for deposit are in-State items. The overwhelming percentage of those under our own regulations could not be held longer than 3 days under our current system in California. And that provides significant protection for most banks in California, just for in-State items. It's the out-of-State long distance items where we get into the longer hold periods. Shaving 2 or 3 days off of those long hold periods for the long distance items would bring us very close to the goals that are set forth in the bill.

I don't see a significant problem in achieving those with the Fed's help.

Senator SHELBY. I think basically you have all expressed strong reservations about the second option of the bill, the one that would call for consumer availability when a bank receives provisional credit with generic categories of exceptions. Is that right, Mr. Monks?

Mr. MONKS. Yes, sir.

Senator SHELBY. Would you prefer that the bill not contain this option and simply mandate that the Fed clean up the return system?

Mr. HEWELL. Yes, I would prefer that it not be an option.

Senator SHELBY. Gentlemen, I appreciate your patience here this morning. Senator Dodd is at another committee hearing. Everybody is going to the floor. It's just part of the Senate I guess or the legislative system. Thank you for appearing before the committee today and I think your testimony, your written and your other testimony, will be helpful to us. Thanks.

Mr. Terrence Kehoe, is he ready?

Mr. KEHOE. Yes, sir.

Senator SHELBY. Mr. Kehoe, I have a vote on the floor right now. It's my second one. What I would like to do is for you to go ahead and give your testimony for the record. The staff will be here and that will conclude our hearing. And then the chairman and other members of the committee might possibly have some questions or statements for you and you can talk informally to the committee.

I would like to ask you this before you testify, this basic question that I asked them. Would a modernization of the system clear up not all perhaps but most of the problems that we have in the holding of the checks because we all know the central question is one of information, isn't it?

Mr. KEHOE. It would certainly accelerate the forwarding process and automation of the return process would accelerate the return process.

Senator SHELBY. And the second question I'd like for you to address is dealing with the return process because everyone here has indicated that that is the slow part of it, not a lot has been done in that regard.

Mr. KEHOE. That's correct.

Senator SHELBY. And I hope you'll excuse me, but I do need to go vote.

Mr. KEHOE. Thank you.

STATEMENT OF TERRENCE KEHOE, NATIONAL FINANCIAL AUTOMATION CORP., MILFORD, CT

Mr. KEHOE. Chairman Shelby and members of the subcommittee, I know that this Senate subcommittee is interested in learning ways of how to improve the check collection process and I'm pleased to be here today.

My name is Terrence F. Kehoe. I am the principal and founder of National Financial Automation Corp. [NFAC], in Milford, CT, and I have pioneered an innovative approach utilizing telecommunications and marketing techniques to drastically improve the check collection process. The proposed service, "CHECKNET", enables financial institutions to profit from shortening the time it takes to clear checks.

A brief background of financial institutions. As mandated by the UCC, the bank of deposit determines negotiability of a check by examining the date, the dollar amount, the writer's signature, and that it is properly endorsed. A forged signature would probably be detected by the account holder upon receiving the monthly statement or it may be realized by the payor institution should the dollar amount be $2,500 or more.

I will just read this one brief section and then it will be helter-skelter and I'll emphasize the important parts.

The depository bank is liable for fraud. It is responsible to know the endorser. Losses from fraudulent checks are recovered by the depository banks blanket bond insurance program.

$500 MILLION LOST EACH YEAR DUE TO MUTILATION AND LOST CHECKS

The Bank Administration Institute [BAI] estimates that banks lose about $500 million a year due to processing mutilation or lost checks. Internal delays of unprocessed checks because of backlogs or transportation delays can result in a $15 to $20 million holdover float which results in a loss of interest earnings. BAI also estimated that 1.2 of every 100 items with an average dollar amount of $529 were held over, representing float loss.

The Federal Reserve has reduced its float to about $1.6 billion per day. However, to restrain this holdover float which is subject to hindrances beyond the control of the Federal Reserve, such as backlogs, seasonal volume fluctuations, traffic, travel time, weather conditions or whatever.

This nonuse of $1.6 billion a day means to the public that the public lost interest earnings of $80 million had the funds been available to be loaned at 5 percent.

The Fed handles about 15.9 billion checks per year. The check processing cost to the consumers to maintain the Federal Reserve System is about $360 million annually.

Because of the amount of time it takes for the checks to clear, float is an inherent inefficiency of the paper-based system. The opportunity for fraud is abundant.

Recently, in New York two individuals were caught kiting some 15,000 checks with a face value of $9.2 billion, more than doubling the E.F. Hutton scheme which bilked some 400 banks out of an estimated $250 million in daily interest free use of funds indicating that hold policies of 400 banks did not work in protecting themselves from check kiting.

The U.S. Justice Department and the Federal Reserve agree that check kiting is not an isolated incident. Aside from the theft of interest earnings from illegal use of funds, real danger exists should a company or individual fail while banks are holding worthless paper. This situation will be very damaging to the financial industry with the public held liable.

Consumers are charged ever-rising account fees as banks identify costs and pass them along with healthy profit margins to account holders.

Consumers think that they have been treated unfairly because only 0.85 percent of the approximately 40 billion checks written annually are returned on first presentment and 60 percent of those are cleared routinely on second presentment. The bottom line is only about 0.02 percent fail because of fraud or that they prove worthless.

NFAC simply leases existing telecommunications companies' networks and resells the enhanced CHECKNET service to the financial industry based on a market need to improve the check collection system.

The Board of Governors of the Federal Reserve System have determined there are no regulatory obstacles to the proposal, supports the objective of CHECKNET and hopes the NFAC proposal is given careful consideration.

The key to improving the payment system is recognizing the importance of the transmission of transaction data in advance of the delivery of the paper check, eliminating the need for high speed, high-cost paper movement while maintaining the general public's widespread preference for the paper check.

THE MECHANICS OF CHECKNET

CHECKNET enables the depository bank, which currently captures the routing and transit number, the writer's account number and dollar amount, to transmit that data instantaneously and error-free at less than 1 cent per check via telecommunications. The payor bank posts the debits to the writer's account and transmits to the depository bank a list itemizing all items it will not honor, eliminating the traditional time lag and the costly manual return process. The depository bank still in possession of the paper check is able to recover insufficient funds from the depositor. The Federal Reserve settles by existing Fed wire or third-party notification is transmitted to the Federal Reserve via CHECKNET. Participating institutions act as both payor and depository institution. This reciprocal agreement creates a wash of funds. For the financial institution and its customer on the disbursement side there may be a float loss and on the collection side there is a float gain, but the transaction data becomes sensitive rather than transporting the formerly time critical pieces of paper.

Implementing underutilized and available telecommunications networks to improve the check collection system will provide same day availability, reduce hold time, losses, operating costs—savings which can hold the line on rising account fees and allow banks to become more competitive. The Federal float is reduced. The Federal Reserve's operating costs are reduced and pending legislation is addressed.

More accurate same day availability enables the bank treasury department to minimize borrowing and maximize investment.

CHECKNET provides the framework for future truncation and implements the processing concepts which require the transmission of data.

THE CATCH-22

NFAC has determined the savings to institutions to be about 171 percent based on an industrywide projection. Financial institutions and potential investors suggest this is too general a projection and that a bottom line, cost-benefit justification is necessary. Banks refer NFAC to the Federal Reserve for funding; the Federal Reserve, in turn, refers NFAC to the financial industry for funding.

Contrary to public interest, in a December 22, 1986, letter, the Board of Governors of the Federal Reserve System to NFAC, it was stated that:

> The Federal Reserve is not soliciting or funding proposals on this subject and will not until there is evidence of greater support from the financial industry.

The only concern the Fed has raised regarding CHECKNET is that there may be problems reconciling electronic data with the physical check. NFAC does not see this as insurmountable. For example, with a check truncation program, you don't reconcile the paper with the statements if you never receive your check.

By eliminating the use of the paper float, electronically initiated items become more enticing. For example, according to the Federal Reserve, the costs to corporations of deposit and collection is up to

$1.50 per check. The ACH entry costs roughly a debit costs 6 cents and a credit costs about 3 cents.

The Financial Institutions customers utilize the automated clearing houses [ACH] service by creating a tape. It is physically delivered by a truck or in some cities by bicycle. It is subject to the same transportation delays as the paper movement. The ACH return process is primarily a paper-based system and it's subject to the same dishonored return entries as the paper-based process.

Check truncation refers to stopping the check somewhere along the payment process. A tape is created and the transaction data is physically forwarded just like the paper-based process. The return process is a manual paper-based process which may enable the financial industry to qualify delayed funds availability.

People enjoy the luxury and convenience of writing checks. Check writing does not need computers or point of sale terminals. They can be negotiated anywhere. According to a BAI study of 1985, there are 61,000 ATM's allowing consumers access to cash, an inroad to the 8-percent of checks written for cash. If a hold is placed on a depositor's account no matter how many times you put your ATM card into the machine, it would be just like squeezing blood from a turnip if there was a hold on the deposit made by check.

There has also been a move to point of sale terminals to displace the check in retail establishments. For the retailer, this is capital intensive. Each register must be equipped with a terminal linked to an electronic network and they are charged network access fees. So until the consumers see added value and/or cost savings of widespread use of ATM cards and SMART cards at retail stores it will be difficult for the retailers to justify point of sale terminals as opposed to accepting a check. The timeframe for impact of point to point systems to make a serious inroad to displace the paper check is unknown.

I agree with disclosures, but it only deals with the symptoms and does not improve the quality of life for Americans by acclerating the payment system. I suggest that the cost of the disclosure program go toward developing EFT networks.

The delay in the time it takes for checks to clear poses the greatest threat to the payment system. I urge this subcommittee to pass S. 344. By mandating a ceiling on hold periods, check processing alternatives become more attractive.

It is argued that the forward process is efficient, but Americans are footing the bill for all this efficiency and being denied access to boot.

Congress should enact legislation to provide the private sector with funds to enable the private sector to research ways into improving the payment system. Since the Fed is a competitor, a panel representing consumers and private industry will ensure objective analysis.

I thank you for your time. I do have one or two remarks I'd like to make. As I said, these are helter-skelter.

The cost of processing a return check is the depository bank's cost of doing business with its customers.

Since the technology exists to improve the payment system, why are we waiting in anticipation of some unforeseen technological breakthrough to displace the check?

If you want to figure out a timeframe for implementation of CHECKNET, we can take a peek at the ACH which grew at 100 percent per year. From its inception in the 1970's to 1983, some 15,000 banks were brought on-line by modifying their systems, which serves as a benchmark for payment system automation.

By the way, one of the remarks that has been made to me by bankers is that they recognized the inevitability of CHECKNET but thought I was cutting into their revenue streams, because banks make money processing paper checks. My response to the banks has been that CHECKNET is a back office operation and what the bank charges its customers in a competitive environment is a business decision which remains the bank's prerogative.

I thank you all for your time.

[The complete prepared statement of Terrence F. Kehoe, response to written questions, and additional material supplied for the record follow:]

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

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8 SEAVIEW AVENUE
MILFORD CONNECTICUT 06460 (203) 878-7149

STATEMENT OF

TERRENCE F. KEHOE
President

Chairman Proxmire and members of the Subcommittee, I am pleased to testify here today. My name is Terrence F. Kehoe. I am the principal and founder of National Financial Automation Corporation (NFAC), in Milford, Connecticut. I have pioneered an innovative approach by applying telecommunication technology and marketing techniques to create a new company dedicated to drastically improved check processing. The proposed NFAC service, "CHECKNET"^{sm} enables financial institutions to profit by shortening the time it takes to clear checks, benefiting the Federal Reserve System and the general public. The theme of my testimony will be that since the technology exists and the United States is facing intense global competition, a modern and accelerated payment mechanism is not only a necessity to improve the quality of life for Americans but is a requisite for success and survival in a constantly changing world.

BACKGROUND

Financial Institutions

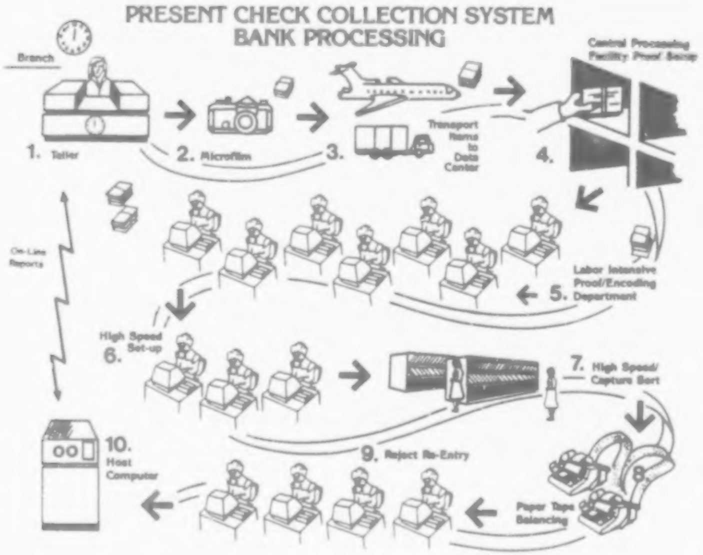
As mandated by the Uniform Commercial Code (UCC), the bank of deposit determines negotiability of a check by examining the date, dollar amount, signature of writer, and that the item is properly endorsed. A forged signature would probably be detected by the account holder upon receiving the monthly statement or it may be realized by the payor institution should the dollar amount be $2500 or more. The depository bank is liable for losses due to fraud. It is its responsibility to know the endorser. Losses from fraudulent checks are recovered by the depository banks blanket bond insurance.

For the depository institution speedy forward check processing is of tantamount importance in order to meet deadlines and receive payment from the Federal Reserve, correspondent bank or payor institution. Approximately 25 percent of the checks received are "on us" items. The remaining 75 percent[1] are "on others" and must be presented for collection through the payment system. During processing activities checks are microfilmed, sorted and presented for payment. The routing and transit numbers which identify the payor bank, writer's account number and dollar amount are posted, captured and filed.

Large workforces are necessary at the central processing center where staffing is difficult since the workforce must be scheduled to meet the arrival of work from the branches and day to day volume fluctuations create staffing problems.

The Federal Reserve System and financial institutions maintain transportation networks including air couriers, ground fleets and are subject to the associated costs of fuel, maintenance and insurance.

ILLUSTRATION 1


PRESENT CHECK COLLECTION SYSTEM
BANK PROCESSING
Branch
1. Teller
2. Microfilm
3. Transport Items to Data Center
Central Processing Facility Proof Setup
4.
Labor Intensive Proof/Encoding Department
5.
On-Line Reports
High Speed Set-up
6.
7. High Speed/ Capture Sort
8.
Paper Tape Balancing
9. Reject Re-Entry
10. Host Computer

For many commercial banks, millions of checks are processed daily through back office operations. A 1974 bank Administration Institution (BAI) estimates banks lose $500 million[2] each year due to processing mutilation, lost or misdirected checks. Internal delays of unprocessed checks because of backlogs due to transportation delays, equipment failures, operational shortcomings, weather conditions, and deposits made late in the day by customers may result in a daily $15 to $20 million[3] holdover float. A 1984 BAI survey revealed 1.2 per 100 items processed with an average dollar value of $529 were held over[4], representing float loss had the funds been available for investment.

Federal Reserve System

The very costly, cumbersome, antiquated time-critical paper based check collection system in the United States is dependent on the physical movement of a check between deposit institution and payor institution entails enormous operating burdens. An estimated 40 billion plus[5] checks are written per year, yet the current check collection system is an anachronism from a time when volume was small.

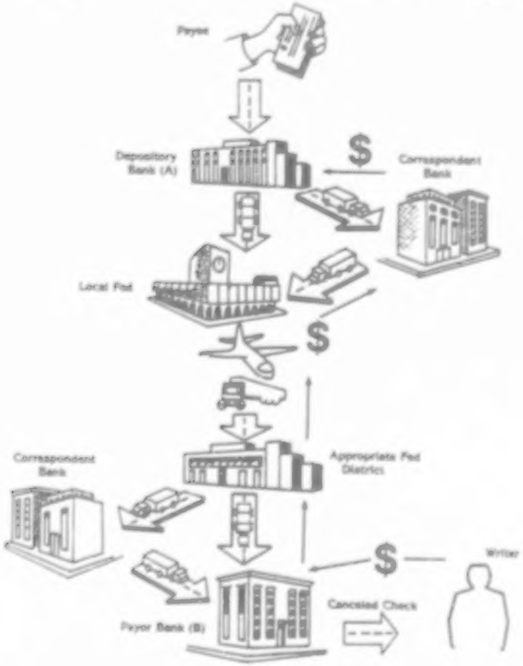
Funds are obtained for the depository bank by sending the check for collection through the Federal Reserve System, correspondent banks, local clearing houses or by sending the item directly to the payor bank or some combination of these means are used. This forward process of sending a check for payment generally takes from one to three days. The actual time required will depend on a variety of circumstances such as the location of the depository institution, the number of intermediary banks involved, holidays, weekends, weather and mechanical breakdowns.

During the forward process credit is extended to each successive institution according to when the check is expected to be paid, usually in one or two business days, in the form of provisional funds creating the federal float. The 1980 Monetary Control Act, passed by Congress, ordered the Federal Reserve to reduce the float. The Federal Reserve has reduced the float to about $1.6 billion per day. However, to restrain this holdover float from increasing at dramatic rates, the Federal Reserve System, which handles about 15.9 billion checks per year, must react to hinderances of the paper based system that are beyond the control of the Federal Reserve, such as backlogs, seasonal volume fluctuations, processing machinery breakdowns, staffing and scheduling, weather, transportation, travel time and traffic.

This non-use of $1.6 billion a day means the public lost interest earning of $80 million at 5% had the funds been loaned as well as opportunities lost through non-productive use of funds. The consumer burden to maintain the Federal Reserve's check collection operating cost is about $360 million annually.

ILLUSTRATION 2

FEDERAL RESERVE SYSTEM



The Return Process

When the payor bank receives receipt of a check it has until midnight of the next day to pay the check or bounce it back. The payor bank may return a check for several reasons such as uncollected funds hold, overdraft position, closed account, stop payment, endorsement error, or other reasons.

The financial industry maintains that delayed funds availability or holds is not policy making, but rather the answer to a fundamental flaw in the check return process. Financial institutions state that in order to protect themselves from an unpaid item, holds must be placed upon the transaction to allow sufficient time for the check to clear.

The Federal Reserve charges banks $0.36[6] to return a check. The check is returned to each preceeding bank with credit along the same reverse path it was forwarded. Unlike the forward process, there is no machine readable characters. It is a completely manual process. Each check must be carefully read to decipher the stamped endorsement which is often illegible. The check is returned by the U.S. Mail and other carriers. There is no dedicated transportation facilities. The average return takes approximately three times as long as the forward process.[7]

Check Kiting

Because of the time it takes for checks to clear, float is an inherent inefficiency in the paper based collection process. The opportunity for fraud is abundant.

An Arthur Anderson study used to justify the S.E.C. from taking stronger action against E.F.Hutton, stated that many of the nation's largest brokerage firms engage in overdrafting. The firms with the largest overdrafts at the end of 1984 were Dean Witter, $596 million; E.F. Hutton, $405 million; Prudential-Bache, $277 million; Drexel Burnham, $164 million and Kidder Peabody, $133 million. An Anderson official noted that these were book overdrafts, the actual overdrafts at the banks were less.[8]

Recently in New York, according to a front page article of the August 11, 1986 Wall Street Journal, two individuals were caught overdrafting some 15,000 checks with a face value of $9.2 billion, more than doubling the E.F. Hutton scheme which bilked some 400 banks out of an estimated $250 million in daily interest free use of funds.

The U.S. Justice Department and the Federal Reserve agree that check kiting is by no means an isolated incident. Aside from the theft of interest earnings from illegal use of free funds, real danger exists should a company or individual fail while banks are holding worthless paper. This situation will be very damaging to the financial industry with the public held liable.

Consumers

The present process has resulted in consumer confusion as customers are denied access to their funds and must suffer the inconvenience and its consequences. Consumers and the general public are charged ever-rising account fees as the financial industry identifies costs and passes them along, with healthy profit margins, to account holders.

Consumers believe they are being treated unfairly since only 0.85 percent of the approximately 40 billion checks written annually are returned on first presentment and 60 percent of those are cleared routinely on second presentment. The bottom line is about only 0.02 percent of all checks eventually prove worthless because of fraud or other reasons.[9]

"Consumers across the country are subjected to lengthy delays in gaining access to their funds. The extent of the problem is suggested by a nationwide survey of 669 banks and savings and loans compiled by the U.S. PIRG this year. A majority of financial institutions surveyed said that checks drawn on a local bank would be held three to five business days. 75 percent announced that they hold out-of-state checks for six business days or over, while 20 percent responded that these checks will be held for two weeks. Check hold periods of as long as 20 business days - nearly a month - were identified."[10]

"A Consumer Federation of America study in 1985 found that the average fee charged to consumers for bounced checks is about $13. The 9.7 million bounced checks due to holds thus cost consumers about $125 million in those fees alone."[11]

NATIONAL FINANCIAL AUTOMATION CORPORATION

The company I founded to ameliorate the check collection process is positioning itself as a reseller of data communications. NFAC simply leases capacity on existing telecommunication companies' networks and resells the enhanced service "CHECKNET" to the financial industry based on the market need to improve the check collection system.

Major corporations, such as US Sprint, AT&T, MCI and others are actively investing significant dollars to build networks and promote their computer to computer services. Because of the proliferation of automation in the financial industry, as financial institutions recognize telecommunications as labor saving, cost saving, in addition to the benefits of speed, efficiency and accuracy, electronic check processing should be positioned for explosive growth.

The Board of Governors of the Federal Reserve System have determined

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM
WAYNE D. ANGELL

Q.1. You stress the danger that strict mandatory availability schedules could encourage check-kiting and fraud. According to the consumer groups that have testified, there is no evidence thus far that the availability schedules adopted by various states have led to an increase in check-kiting or check-related fraud. Do you agree? If so, how do you account for the result?

A. 1. Strict mandatory availability schedules may encourage check-kiting and other fraud if they require funds availability before the completion of the normal collection and return cycle. An individual perpetrating a kite under such schedules would be able to rely on obtaining availability before the check is returned.

Under most of the availability schedules adopted by the various states, a depositor cannot rely on the fact that funds will be made available before the institution learns of the nonpayment of an item, making it more difficult to perpetrate a kite. The lack of evidence of significant increases in check fraud in these states is most likely due to the fact that the state schedules accommodate the length of the collection and return cycle for a significant portion of checks deposited.

In contrast, the approach taken in section 5(c) of S. 344 would require an institution to make funds available on the date it receives provisional credit. Thus, funds must be made available (subject to the exceptions) before there is any opportunity to learn of nonpayment. This creates the ideal circumstances for the potential check kiter.

The risk of check fraud is greatly reduced under the approach taken in section 5(b) of the bill. Under this alternative, schedules would be devised so that the receiving institution can reasonably expect to learn of nonpayment before availability must be given.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM

ALAN FOX, SAMUEL COOPER, GAYLE K. LAWRENCE, FRANCI LIVINGSTON, AND MICHELLE MEIER

Q. 1. On page 8 of its written statement, the American Bankers Association proposes that business accounts be excluded from S. 344, and that the bill apply only to accounts that are used primarily for personal, family, or household use. Would such a limitation be acceptable to your organizations?

A.1. Although our primary concern is with accounts held by families and individuals, we are sympathetic to the needs of small businesses and other organizations or entities that lack the power to negotiate account terms with financial institutions. "Business" accounts are held by community and civic organizations, nonprofits, unincorporated businesses and partnerships, and by individuals performing part-time work who must, for tax or other reasons, segregate funds from such work from their household accounts. These accountholders are not able to negotiate the same favorable treatment for their accounts that larger businesses enjoy. They should have the same protections as other consumers.

Q. 2. On pages 7-8 of its written statement, the ABA contends that the provisions of S. 344 should be extended to money market mutual funds that can be used like checking accounts. Do you agree?

A.2. We see no need to apply S. 344 to money market mutual funds (MMMFs) at this time. There is no definitive evidence documenting abuses in this area. MMMFs are not themselves depository institutions, but must maintain accounts at depository institutions into which they deposit fund contributions. Since MMMFs rely on accounts in depository institutions, any undue availability delays that exist today should be eliminated by the application of S. 344 to depository institutions. If this does not occur, and if problems in current practices can be documented, consideration of additional legislation would be appropriate.

Q. 3. On page 9 of his written statement, Governor Angell states that the proposed Expedited Funds Availability Council "would duplicate the responsibilities of several other groups," such as the Fed's Consumer Advisory Council. Do you agree?

A.3. The Consumer Advisory Council, on which representatives of consumer interests are in the minority, would be of limited value in ensuring that the intent of the law is fully carried out. Its wide range of responsibilities, lack of independent staff, and limited meeting time would probably allow it little ability to influence implementation of the law. The proposed Council could be useful as a forum dedicated specifically to consideration of issues arising from this bill. It would, however, suffer from many of the same weaknesses as the Consumer Advisory Council. We note that the most recent version of the bill makes no provision for the Council, and do not feel that the Council is necessary to the implementation of the bill.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM
ROBERT C. HEWELL

Q.1. On page 5 of your written statement, you ask us to consider language to ensure that private sector providers of payment services will have a role in any new check-return system. Do you have specific language for us to consider?

PROPOSED AMENDMENT TO
COMPETITIVE EQUALITY BANKING ACT
TO ENSURE COMPETITIVE EQUITY
COMMITTEE PRINT III

On page 131, section 612, line 2, insert after "612.":

"(a)"

On page 131, section 612, after line 14, add a new subsection to read as follows:

> "(b) COMPETITIVE EQUITY. -- In prescribing regulations, the Board, as both principal regulator and primary competitor of other providers of payments system services, shall
>
> > ensure that its fees are based on costs used by other providers of payments system services in determining pricing of such services, including, but not limited to those cost factors identified in the pricing provisions of Section 11A of the Federal Reserve Act.

On page 132, section 614, add a new subsection to read as follows:

> "(c) PAYMENTS OF SERVICES. -- The Board shall not be exempted from paying fees for services which are provided to it by private sector providers of payments system services."

Explanation of Amendment

The Board will ensure that in determining the pricing of its payments system services it takes into account factors used by other providers of payments system services.

In the development of an accelerated payments system, the Board shall encourage fair competition and not restrict the introduction of services by other providers of payments system services.

The Board is not to be exempted from payment for services for which the Board began charging fees with the inception of the Monetary Control Act of 1980. Presently, the Board does not pay for services provided by other providers of payments system services, which has resulted in Federal Reserve fees being subsidized by other providers of payments system services.

Need for Amendment

Because of the Board's dual role as primary regulator and main provider of payments system services, this amendment ensures the continued existence of a competitive payments system. The Board in pricing its payments system services will have to take into account all direct and indirect costs actually incurred and an allocation of imputed costs which takes into account taxes that would have been paid and the return on capital that would have been provided had the services been provided by a private provider. This goal, which was originally adopted by the Congress in the 1980 Monetary Control Act, must be preserved and reiterated in S.344.

To maintain a competitive equity between the Board and the private sector, this amendment also reiterates the Congress' intent to allow other providers of payments system services full access to check payments system services in new areas as long as they are competitively priced. In addition, the Board, as the primary regulator, should seek to maintain a strong private sector. Private providers of payments system services have often been at the forefront in the development of speedier and more cost efficient technologies, and their continued role in our nation's payments system is essential to ensure that our nation's consumer is best served.

Presently, the Board benefits of an uncompetitive advantage with a substantial impact on the cost of its services. Federal law exempts the Board from paying for some services provided by the private sector. To restore a competitive balance, it is therefore essential that the Board not be exempted from paying for those services which it charges other providers of payments system services.

there are no regulatory obstacles to the proposal, supports the objective of "CHECKNET" and hopes the NFAC proposal is given careful consideration by the private sector.

Readily available telecommunications is the key to improving the payment system. Recognizing the importance of the transmission of transaction data in advance of the delivery of the paper check, eliminates the need for high speed, high cost paper movement, while maintaining the general public's wide spread preference for the paper check.

The banking industry has already installed the computer hardware on the sending and receiving ends. Procedure modification, rather than technological capital investment, will bring the check collection system into the proven electronic funds transfer world, benefiting the Federal Reserve System, financial institutions and the general public with a drastically improved paper-based system.

National Financial Automation Corporation's "CHECKNET" enables the depository or intermediary bank, which currently captures the routing and transit number, the writer's account number and dollar amount, to transmit the data instantaneously and error free, at less than a cent per check, to the payor bank via telecommunications. The payor bank posts the debits to the writer's account and transmits to the depository bank a list itemizing all items it will not honor and dollar total it will pay, eliminating the traditional time lag and the costly manual return process. The depository bank is able to recover insufficient funds from the depositor. The Federal Reserve settles via existing Fed wire or third party notification which is transmitted to local Federal Reserve Systems for settlement through "CHECKNET." Participating financial institutions act as both a depository and payor bank. This reciprocal agreement creates a wash of funds. For the financial institution and the customer on the disbursement side there may be a float loss and on the collection side there is a float gain. The payor bank still receives its canceled checks, but the transaction data becomes sensitive, rather than transporting the formerly time critical pieces of paper.

Easily implementing underutilized and available telecommunications networks to improve the financial institutions' check collection process will provide same day availability, reduce -- hold time, losses, operating costs -- savings which can hold the line on rising account fees and all w banks to become more competitive. The Federal Float is reduced, the Federal Reserve's operating costs are reduced; pending legislation is addressed, and the Federal Reserve's obligation to insure a safer, more secure system by reducing clearing time and performing in the public good is fulfilled.

"CHECKNET" displaces costs resulting from eliminating the critical time factors involved in check transportation. Financial institutions will simultaneously maintain both the paper based system and the "CHECKNET" process; yet the per item cost of incorporating "CHECKNET" replaces labor - an increasing cost - with computer time - a decreasing cost. For traditional check processing, improving production, reducing operating costs and eliminating loss of available funds is a costly conflicting task. For example, will the interest earnings of adding an additional check delivery messenger offset the incremental direct costs? Utilizing "CHECKNET," as the number of transactions increase, the unit cost of labor and equipment decrease.

"CHECKNET" provides the automated data forward and return framework for future truncation and image processing concepts which require networks for information transmission.

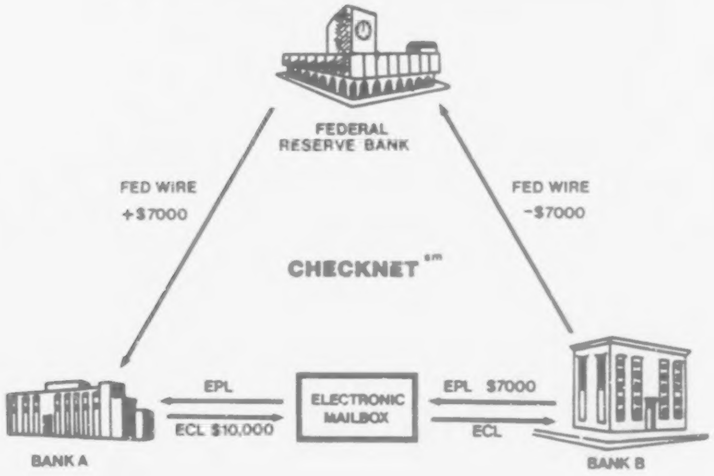
The Federal Reserve also proposed a concept of electronic sends which was not well received by the banking industry because pricing was not determined, and a study indicating it was cost effective was not undertaken. Subsequently it was abandoned. NFAC has determined financial institutions' savings at about 171% based on industry wide projection. Financial institutions and potential investors suggest this is too general a projection and that a bottom line, cost-benefit justification, is necessary. Banks refer NFAC to the Federal Reserve for funding of the study. The Federal Reserve, in turn, refers NFAC to the financial industry.

Contrary to public interest, in a December 22, 1986 letter from the Board of Governors of the Federal Reserve System to NFAC, it was stated at this time "the Federal Reserve is not soliciting or funding proposals on this subject and will not until there is evidence of greater support from the financial industry." In light of the many benefits of "CHECKNET" and because it is in the public interest, funding to perform the analysis should be provided by the leadership of the Federal Reserve.

The only concern the Federal Reserve has raised regarding "CHECKNET" is that there may be problems reconciling the electronic data with the physical check. NFAC does not believe this to be insurmountable. It is important to note a feasibility analysis of the reconciliation sticking point has not been performed to measure workability. The question that transends the reconciliation issue is whether it is necessary to reconcile the electronic statement to the physical copy. For example, with check truncation, the consumer is unable to reconcile the physical check to the statement. Should a customer not receive a check under the "CHECKNET" plan, the writer could obtain a photocopy from the financial institution's standard operating procedure by referring to the "CHECKNET" transaction identification or sequence number. However, should it be necessary to

ILLUSTRATION 3

National Financial Automation Corporation


FEDERAL RESERVE BANK
FED WIRE
+$7000
FED WIRE
-$7000
CHECKNET sm
EPL
ECL $10,000
ELECTRONIC MAILBOX
EPL $7000
ECL
BANK A
BANK B

Advantages

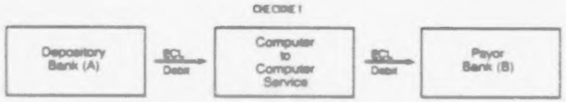
- o Reciprocal exchange
- o Eliminates high-cost, high-speed paper movement
- o By-passes traditional return item process
- o Utilizes current systems
- o High-volume, low-cost process

ILLUSTRATION 4

National Financial Automation Corporation

CHECKNET sm

Depository Bank	NFAC/CHECKNET	Payor Bank
Produces Electronic Cash Letter, ECL. Transmits to NFAC	Sorts entries. Transmits to Bank of Origin	Posts debits to writer account. Formulates Electronic Payment Letter, EPL.


CHECKNET
Depository Bank (A)
ECL
Debit
Computer to Computer Service
ECL
Debit
Payor Bank (B)

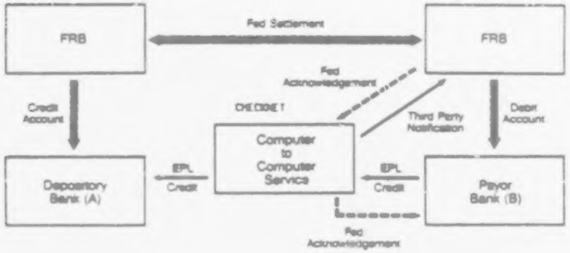
NFAC

ILLUSTRATION 5

National Financial Automation Corporation

CHECKNET sm

PAYOR BANK	NFAC/CHECKNET	DEPOSITORY BANK
Transmits Electronic Payment Letter (EPL) to NFAC computer-to-computer service.	Sorts entries, delivers to Depository Bank. Notifies FRB for settlement.	Invests funds. Acts regarding dishonored checks.

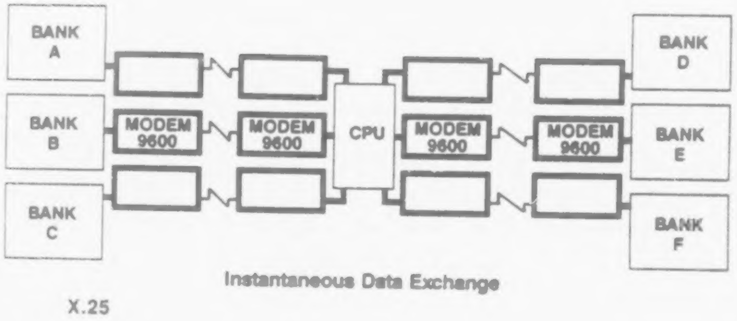

FRB
Fed Settlement
FRB
Fed Acknowledgement
Credit Account
CHECKNET
Third Party Notification
Debit Account
Computer to Computer Service
Depository Bank (A)
EPL
Credit
EPL
Credit
Payor Bank (B)
Fed Acknowledgement

NFAC

ILLUSTRATION 6

National Financial Automation Corporation

CHECKNET sm


BANK A
BANK B
BANK C
MODEM 9600
MODEM 9600
CPU
MODEM 9600
MODEM 9600
BANK D
BANK E
BANK F
X.25

Instantaneous Data Exchange

reconcile, banks have historically implemented successful related systems capable of reconciling an electronic statement sent in advance of the physical copy which serves as benchmarks. For instance, the United States Treasury successfully implemented electronic sends and is capable of reconcilation.

TRENDS

Automated Clearing Houses (ACH)

By eliminating the use of the paper float, electronically initiated transactions become more enticing. For example, according to statistics published by the Federal Reserve System, the cost to corporations of deposit and collection is up to $1.50 per check. For paperless entries, the ACH products cost financial institution customers roughly $0.06 per debit which are corporate trade payments such as insurance, utilities and mortgages and about $.03 per credit. Credits are direct deposits including payroll, dividends and pensions.

The Financial Institution customer utilizes the ACH service by creating a computer tape of its payroll (or other transaction), physically delivering the tape by truck, or in some cities by bicycle, to its financial institution providing the ACH service. "On us" items are stripped off and posted to the employee account. The forward process continues as an "on other" tape is created and physically delivered through the ACH network. The ACH products are subject to the same transportation delays of the in use check collection process. In contrast to the electronic forward system, the ACH return process is primarily a manual paper based system. ACH dishonored entries are returned for the same reasons as the paper based process.

Check Truncation

Truncation refers to stopping the check somewhere in the collection process. A tape is created containing the transaction data which is physically forwarded. The writer receives only the monthly statement listing paid checks. The consumer is unable to reconcile the physical check to the statement. When necessary, a copy of a canceled check is available from a microfilm file. While truncation offers operating savings, it also increases back office labor costs as the absence of a paid check as a receipt from the customer's statement generates demand for photo copies. The return process is a manual paper based process which may enable the financial industry to qualify delayed funds availability.

RECOMMENDATIONS

The delay in the time it takes for checks to clear possess the greatest threat to the payment mechanism, not consumer fraud. It is obvious financial institutions' hold policies are ineffective against overdrafting. The American public has proven themselves to be acutely capable of handling financial accounts. I urge the Subcommittee to pass S. 344 by mandating a ceiling on hold periods of zero to three days upon passage.

We have learned the expensive check collection process is riddled with inefficiencies and no longer provides the nation with a safe, secure payment system. The Federal Reserve ought to determine how widespread overdrafting is and its impact on the financial industry, develop technical safeguards and an automated return process to accelerate the payment process which will prohibit overdrafting, ensure availability and allow consumers quick access to their funds.

Congress should enact legislation to encourage the Federal Reserve to seek private sector solutions by providing funds to the private sector to research ways of improving the payment system. Means should be sought to lessen the general public's financial burden by lowering the Federal Reserve's check collection operating costs. In the future, fines collected from abuses in the payment system could be earmarked for insuring payment system integrity.

I suggest the Federal Reserve be authorized by Congress the authority to charge a payor bank before the physical check is presented. Because there is a float loss, the Federal Reserve's legal authority has been questioned by the banking industry.

CONCLUSION

The problem is the movement of pieces of paper. In the past the financial industry tended to deal with the symptoms rather than the cause.

The major advantage of existing electronic banking technology is that it is so fast it is not subject to delayed availability.

Given the current state of the banking industry, in addition to the general public need for payment system improvements, and prior to Congress approving legislation authorizing banks the right to incur increased risk from pursuing new markets by exercising securities' powers, the financial industry ought to seek cost effective ways of delivering service which conform to consumer needs while maintaining healthy profits and growth margins by reducing operational overhead costs in existing markets. This will allow U.S. banks to become more competitive with non-bank banks, and foreign banks competing in shrinking domestic markets.

Mr. Chairman and members of the Subcommittee, I commend you for holding these hearings and thank you for allowing me to contribute.

NOTES

[1] Statement of Preston Martin, Vice Chairman, Board of Governors of the Federal Reserve System before the Subcommittee on Financial Institutions. Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, United States House of Representatives. Ninety-Ninth Congress on HR 2443, October 10, 1985, p. 216 (hereinafter referred to as House Hearings).

[2] "Bank Hold Up Report:" Florida Public Interest Research Group. Included in Hearing before the Subcommittee on Consumers Affairs of the Committee on Banking, Housing and Urban Affairs, United States Senate, Ninety-Eighth Congress, First Session on S 573, September 28, 1983, p. 207.

[3] Mahert, V.A., Fairhurst, R., Kilpatrick, M. Chemical Bank Encoder Daily Shift Scheduling System, Journal of Bank Research, Vol 10, No. 3 (Aut, 1979).

[4] Ferris, T. "Check-Processing Maybe Nearing Peak Efficiency, BAI Analyst Says." American Banker, Vol. 150, Issue 60, Mar 27, 1985, p. 15.

[5] House Hearings, p. 216.

[6] Statement of Preston Martin, Vice Chairman of the Federal Reserve Board Hearing on the Fair Deposit Availability Act before the Subcommittee on Financial Institutions of the House Committee on Banking Financial and Urban Affairs, Nineth-Eighty Congress, Second Session, April 4, 1984, p. 214.

[7] House Hearings, p. 217

[8] Nash, N.C. "Hutton Auditor Defends Role," The New York Times, October 4, 1985, p. D3.

[9] Walters, R. "It's Time to Scuttle 'the Float,'" Journal-Courier, CT, June 11, 1986, p. 15.

[10] Testimony of Michael Caudell-Feagan staff attorney, U.S. Public Interest Research Group, House Hearings, p. 312.

[11] Statement by Alan Fox, Legislative Federation of America, House Hearings, p. 289.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM DONALD R. MONKS

Q.1. On Pages 7-8 of your written statement, you propose that S. 344 be extended to money market mutual funds that can be used like checking accounts. Governor Angell testified that, in his view, such mutual funds should not be covered by deposit availability requirements; he cited operational constraints on withdrawals from such mutual funds and the fact that mutual funds are not subject to reserve requirements. What is your reply?

As stated in our testimony, ABA believes that money market mutual funds should be subject to any funds availability legislation. In responding to the question of whether money market mutual funds should be subject to the legislation, Governor Angell spoke of checks drawn on money market funds, (technically drafts) not checks deposited into such accounts which is the focus of the issue of funds availability.

We propose that checks deposited into money market mutual funds be subject to any funds availability schedule. This is a different issue from whether an institution accepting a money market mutual fund draft is subject to the schedule. (Drafts deposited into depository institutions are already subject to the schedule under S.344 under the definition of "check or similar instrument.").

Checks deposited into a money market mutual fund are processed just as any other check is. The money market mutual funds are only subject to the same constraints as a small bank or a bank that uses a correspondent bank; they use a bank to process checks deposited into their customers' accounts, much like a bank that uses a correspondent bank to process checks.

Q.2. What justification is there for placing a hold on a government check or a cashier's check beyond the time needed for the bank of deposit to get provisional credit for the check? To the extent that you are concerned about fraud, please explain how current hold periods prevent fraud.

Generally, banks do not place holds are not placed on government checks or cashier's check when the payee named on the check is a customer of the bank.

Complaints have primarily arisen that financial institutions refuse to cash government checks or cashier's checks for noncustomers. The danger in cashing these types of checks when the person presenting the check (the endorser) is a noncustomer is not that the check is uncollectable. Rather, the danger is that the payee named on the check and the person presenting the check are not the same person. This can occur when a check is stolen by someone known or unknown to the payee.

Under Uniform Commercial Code principles, the bank accepting the check has the ultimate responsibility to know the endorser and assures all other institutions that handle the check that it is a legitimate endorsement. Accepting a check when the endorser is not known to the bank weakens the check processing chain. If the endorsement is later found to be improper, that is, the person presenting the check was not in fact the payee, the bank that cashed the check must suffer the loss.

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Washington, D.C. 20001
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President Irving J. Stolberg
Speaker
House of Representatives
Connecticut

Executive Director
Earl S. Mackey

STATEMENT BY

SENATOR LEO GANNON

RHODE ISLAND STATE SENATE

ON BEHALF OF THE

NATIONAL CONFERENCE OF STATE LEGISLATURES

SUBMITTED TO THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

SENATE COMMITTEE ON BANKING,

HOUSING, AND URBAN AFFAIRS

REGARDING

EXPEDITED FUNDS AVAILABILITY LEGISLATION

Denver Office: 1050 17th Street • Suite 2100 • Denver, Colorado 80265 • 303/623-7800

MR. CHAIRMAN, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THANK YOU FOR ALLOWING US TO SUBMIT THIS STATEMENT FOR THE RECORD, OUTLINING NCSL'S POLICY FAVORING FEDERAL CHECK HOLD LEGISLATION.

AS YOU PROBABLY KNOW, NCSL REPRESENTS ALL OF THE NATION'S 7,461 STATE LAWMAKERS. NCSL'S POLICY RESOLUTIONS ARE ADOPTED BY AN AFFIRMATIVE VOTE OF AT LEAST THREE-QUARTERS OF THE STATES ATTENDING OUR STATE-FEDERAL ASSEMBLY. OUR POLICIES, INCLUDING THE POLICY FAVORING FEDERAL CHECK HOLD LEGISLATION, THEREFORE CONSTITUTE GENERAL AGREEMENTS AMONG STATE LEGISLATORS THAT TRANSEND PARTY, REGION, AND PHILOSOPHY.

THE CONSENSUS IN FAVOR OF FEDERAL LEGISLATION AMONG AS DIVERSE A GROUP AS OUR NATIONS' STATE LEGISLATORS REFLECTS, I THINK, THE DEPTH AND BREADTH OF PUBLIC FRUSTRATION OVER BANK CHECK HOLD POLICIES. STATE LEGISLATORS ARE ARGUABLY THE ELECTED OFFICIALS CLOSEST TO THE PEOPLE, AND WE HEAR FROM THEM REGULARLY ON BANK CHECK HOLD PROBLEMS. BETWEEN 5.5 MILLION AND 10 MILLION AMERICANS HAVE FACED SIGNIFICANT PROBLEMS WITH FUNDS AVAILABILITY, AND MANY MILLIONS MORE HAVE BEEN INCONVENIENCED BY BANK CHECK HOLD POLICIES. THE STATES HAVE RESPONDED TO THIS PROBLEM BUT OUR EFFORTS ALONE ARE NOT ENOUGH. WE NEED YOUR HELP. IN THIS REGARD, I APPLAUD YOUR INITIAL EFFORTS MR. CHAIRMAN, TO RESOLVE THIS MATTER THROUGH THE INTRODUCTION OF S. 344.

TO DATE, THIRTEEN STATES HAVE ENACTED LEGISLATION ON CHECK HOLDS, RANGING FROM MAXIMUM TIME LIMITS FOR FUNDS TO BE CREDITED TO A DEPOSITOR'S ACCOUNT TO THE DISCLOSURE OF BANK CHECK HOLD POLICIES. IN 1983, NEW YORK AND CALIFORNIA BECAME THE FIRST STATES TO ENACT MAXIMUM TIME LIMITS AND DISCLOSURE POLICIES FOR CHECK HOLDS. SIX STATES, CONNECTICUT, ILLINOIS, MISSOURI, MASSACHUSETTS, WISCONSIN AND RHODE ISLAND, FOLLOWED SUIT BY ENACTING MAXIMUM TIME LIMITS AND DISCLOSURE REQUIREMENTS FOR CHECK HOLDS.

AMONG THE EIGHT STATES WITH TIME LIMITS FOR CHECK HOLDS, ONLY NEW YORK AND MASSACHUSETTS SET TIME LIMITS THROUGH REGULATION. THE OTHER SIX STATES ESTABLISHED MAXIMUM TIME LIMITS BY STATUTE.

IN ADDITION TO THOSE EIGHT STATES, HAWAII, NEW JERSEY, MARYLAND, MONTANA AND OREGON REQUIRE DISCLOSURE OF BANK CHECK HOLD POLICIES. SUMMARIES OF STATE ACTIONS APPEAR IN THE ATTACHED CHARTS.

THE JUSTIFICATION FOR THIS STATE LEGISLATION IS CLEAR. CHECK HOLD PERIODS CAN LAST TWO OR THREE WEEKS. THIS EXERTS A CONSIDERABLE HARDSHIP ON LOW AND MIDDLE-INCOME FAMILIES THAT MUST OF NECESSITY LIVE FROM CHECK TO CHECK. LONG CHECK HOLD PERIODS CANNOT BE JUSTIFIED WHEN LESS THAN ONE PERCENT OF CHECKS ARE RETURNED UNPAID AND WHEN INSTITUTIONS EARN CONSIDERABLE INCOME ON THE FLOAT AND RETURNED CHECK FEES.

WHILE THERE ARE JUSTIFIABLE REASONS TO RESTRICT ACCESS TO SOME DEPOSITORS SUCH AS THOSE OPENING NEW ACCOUNTS OR KNOWN BAD-CHECK WRITERS, THERE IS NO GOOD RATIONALE FOR INCLUDING LEGITIMATE CUSTOMERS UNDER AN UMBRELLA OF SUSPICION FOR EXCESSIVE PERIODS. WE HAVE WAITED IN VAIN FOR VOLUNTARY ACTION ON THE PART OF FINANCIAL INSTITUTIONS. CHECK HOLDS CONTINUE TO BE APPLIED BY MANY INSTITUTIONS TO ESTABLISHED CUSTOMERS, TO PERSONS WELL-KNOWN IN THE COMMUNITY WHO DEPOSIT TAX REFUNDS AND SIMILAR GOVERNMENT CHECKS, AND TO MANY OTHERS WHO PRESENT MINIMAL RISK. THE PATIENCE OF MY CONSTITUENTS IS AT AN END. I AM SURE THAT YOUR CONSTITUENTS FEEL THE SAME WAY. AS I NOTED, SEVERAL STATES INCLUDING RHODE ISLAND HAVE ENACTED CHECK HOLD LEGISLATION, BUT THE VALIDITY OF STATE REGULATION OF FEDERALLY-CHARTERED INSTITUTIONS IS IN DOUBT. AS A CONSEQUENCE, THE MEMBERS OF NCSL HAVE CONCLUDED THAT FEDERAL CHECK HOLD LEGISLATION IS AN IMMEDIATE NECESSITY.

THE ARGUMENT BY FINANCIAL INSTITUTIONS THAT LONG CHECK-HOLD PERIODS ARE

NECESSARY SIMPLY WILL NOT HOLD WATER. ONLY 0.85 PERCENT OF ALL CHECKS ARE RETURNED AND MOST OF THOSE ARE FOR SMALL AMOUNTS. RETURNED CHECKS FOR OVER $2,500 CONSTITUTE ONLY 0.04 PERCENT OF ALL CHECKS WRITTEN. NOR DOES A RETURNED CHECK NECESSARILY INVOLVE A LOSS FOR THE BANK. THE FUNDS, ALONG WITH A RETURNED CHECK FEE, ARE USUALLY RECOVERED FROM THE DEPOSITOR. BANKS TAKE IN OVER $3 BILLION ANNUALLY IN RETURNED CHECK FEES. LONG CHECK HOLD PERIODS ALSO ALLOW INSTITUTIONS TO PLAY THE "FLOAT" AND EARN MILLIONS ON INTEREST FREE LOANS FROM CONSUMERS. THESE FACTS SUGGEST THAT LONG-CHECK HOLD PERIODS MAY BE MORE EFFECTIVE AS A MEANS OF INCREASING BANK FEE INCOME THAN A MEANS OF CONTROLLING RETURNED CHECKS.

I AGAIN WANT TO EMPHASIZE THE IMPORTANCE OF THIS LEGISLATION TO THE AVERAGE AMERICAN. MIDDLE-INCOME FAMILIES SHOULD BE ABLE TO WITHDRAW DEPOSITED FUNDS WITHOUT LONG AND UNNECESSARY DELAYS. THEY ALSO NEED SOME PREDICTABILITY IN BANK CHECK HOLD POLICIES IN ORDER TO MAKE THEIR OWN FINANCIAL PLANS. CHECK HOLD POLICIES ARE INCONSISTENT AND APPLIED ARBITRARILY. A BANK ON ONE SIDE OF A STREET MAY IMPOSE A TWO-DAY HOLD ON OUT-OF-STATE CHECKS WHILE A COMPETITOR ACROSS THE STREET IMPOSES A TWENTY-ONE DAY HOLD ON SIMILAR INSTRUMENTS. EVEN BRANCHES OF THE SAME FINANCIAL INSTITUTION MAY HAVE VARYING LIMITS ON FUND AVAILABILITY. THE PUBLIC IS CONFUSED, FRUSTRATED, AND JUSTIFIABLY ANGRY.

AMERICA'S STATE LEGISLATORS AND THE AMERICAN PUBLIC SUPPORT YOU AND APPLAUD YOUR EFFORTS, MR. CHAIRMAN. WE RECOMMEND SPEEDY ENACTMENT OF CHECK HOLD LEGISLATION BY CONGRESS. WE WOULD ALSO STRONGLY URGE CONGRESS TO RESIST ANY LANGUAGE THAT WOULD PREEMPT STRICTER STATE STANDARDS OR THAT WOULD ENCOURAGE PREEMPTION OF STATE LEGISLATION BY FEDERAL AGENCY REGULATION.

I AM CONFIDENT THAT YOU WILL BE ABLE TO RESOLVE THROUGH LEGISLATION THE CHECK HOLD PROBLEM AND OUR OTHER PRESSING PROBLEMS RELATED TO FEDERAL BANK REGULATION. I AM ALSO CONFIDENT THAT YOU ARE AS COMMITTED AS WE ARE TO THE DUAL BANKING SYSTEM AND THAT YOU WILL TAKE CARE NOT TO UNNECESSARILY PREEMPT STATE LAW. AGAIN, WE URGE YOU TO ACT EXPEDITIOUSLY. THIS PARTICULAR ISSUE IS THE SINGLE BIGGEST SOURCE OF CONSUMER FRUSTRATION.

THANK YOU FOR THIS OPPORTUNITY TO SUBMIT OUR VIEWS.

SUMMARY OF STATE ACTION

CHART I

STATE CHECK HOLD/FUNDS AVAILABILITY POLICIES

State	Legislation	How Time Limits are Determined	Local Depository Institution	In-State Depository Institutions Other than Local	Out-of-State Depository Institution
California	AB-1723 (1983)	Regulation	1 Day	2-4 Days (4-5 Days For Thrifts and Credit Unions)	8-9 Days (9-10 Days for Thrifts and Credit Unions)
Connecticut	PA-85-194 (1985)	Statute	4 Days	4 Days	7 Days
Hawaii	SB-1574 (1986)	N/A	----	----	----
Illinois	SB 525 (1985)	Statute	4 Days	4 Days	7 Days
Maryland	PA-85-751	N/A	----	----	----
Massachusetts	PA-390 (1984)	Regulation	2 Days	3 Days	5 Days (3 Days in New England States)
Missouri	HB-1155 (1986)	Statute	1 Day	1 Day if Same Federal Reserve District, if Different Federal Reserve District, 6 Days	
Montana	HB 423 (1985)	N/A	----	----	----
New Jersey	SB-1503 (1984)	N/A	----	----	----
New York	AB-7054 (1983)	Regulation	2 Days (3 Days-Thrifts)	3 Days (4 Days-Thrifts)	6 Days (8 Days-Thrifts
Oregon	HB-3016 (1985)	N/A	----	----	----
Rhode Island	PL-378 (1985)	Statute	2 Days (1 Day if Drawn on	4 Days (5 Days for Thrifts	6 Days (Fed. Res. Dists.

			Same Bank; 3 Days for Thrifts & Credit Unions)	& Credit Unions)	1 & 2 - Other than In-state) 8 Days (All Other Out-of-state Areas; 9 Days for Thrifts & Credit Unions)
Wisconsin	SB-642 (1985)	Statute	4 Days	4 Days	7 Days

NOTE: Days typically refer to business days.

CHART II

STATE FUNDS AVAILABILITY POLICIES

State	U.S. Treasury Drafts	Local/State Government Drafts	Deposits at Electronic Facilities	Cashier's Checks
California	1 Day	1 Day	Option to Add One Day	0 Days - Banks and Credit Unions Under Specific Conditions
Connecticut	----	----	----	----
Hawaii	----	----	----	----
Illinois	1 Day	1 Day	----	----
Maryland	----	----	----	----
Massachusetts	2 Days	----	Add 1 Day	----
Missouri	0 Day	0 Day	1 Day	0 Day
Montana	----	----	----	----
New Jersey	----	----	----	----
New York	1 Day	1 Day	Add 1 Day	----
Oregon	----	----	----	----
Rhode Island	1 Day	1 Day	----	1 Day (Under Specific Conditions)
Wisconsin	1 Day	1 Day	----	----

CHART III

STATE FUNDS AVAILABILITY

POLICY EXCEPTIONS

State	Institutions Can Make Funds Available More Quickly Than Check Hold Period	Institutions/ Consumer Can Agree to Longer Hold Periods Than Usual	Longer Check Holds Due to Sum of Items Deposited	Longer Check Holds Because of Previous Overdraft Problems
California	Yes	----	Bank Policy Prevails for Item(s) Over $2,500	Yes - Bank Policy Prevails When 3 Overdrafts in 6 Month Period
Connecticut	Yes	----	----	----
Hawaii	----	----	----	----
Illinois	----	----	----	----
Maryland	----	----	----	----
Massachusetts	----	Yes	Bank Polcy or Collection Basis for Item(s) of $2,500 or More	Yes - Bank Policy Prevails When 3 Overdrafts in 6 Month Period
Missouri	Yes	----	----	Yes Bank Policy Prevails When 3 Overdrafts in 6 Month Period
Montana	----	----	----	----
New Jersey	----	----	----	----
New York	Yes	Yes	Bank Policy of Collection Basis for Item(s) of $2,500 or More	Yes - Bank Policy Prevails When 3 Overdrafts in 6 Month Period

Oregon	----	----	----	----
Rhode Island	Yes	----	Bank Policy or Collection Basis for Item(s) Over $2,500	----
Wisconsin	Yes	----	----	Yes Bank Policy Prevails When 3 Overdrafts in 6 Month Period

CHART III - (Continued)

State	Longer Check Holds Because an Institution Doubts Collectibility	Longer Check Holds Due to Emergencies, Uncontrolled Situations	Longer Check Hold Because State Regulator Determines Extension is Necessary	Exemption For New Accounts
California	----	Yes	----	Yes
Connecticut	Yes	----	Yes	Yes
Hawaii	----	----	----	----
Illinois	Yes*	----	----	----
Maryland	----	----	----	----
Massachusetts	Yes	Yes	----	Yes
Missouri	Yes	Yes	----	Yes
Montana	----	----	----	----
New Jersey	----	----	----	----
New York	Yes	Yes	----	Yes
Oregon	----	----	----	----
Rhode Island	----	----	----	Yes
Wisconsin	Yes	----	----	Yes

CHART IV

DISCLOSURE OF CHECK HOLD/FUNDS AVAILABILITY POLICIES

State	How Mandated	Disclosure Techniques (Not Inclusive)
California	Regulation	1. In writing to new customers
		2. Post notice in conspicuous place in all depository institutions
		3. Teller must disclose if a hold will be imposed at time of deposit
Connecticut	Statute*	1. Post notice in each branch explaining time limits
		2. Inform all customers in writing
Hawaii	Statute	1. Notice of check hold policy upon request
Illinois		1. Disclose policies when customer makes initial deposit and at least once per year thereafter.
Maryland	Statute	1. Opening account, in writing
		2. Upon demand, in writing
Massachusetts	Statute/ Regulation	1. Upon request, in writing
		2. Disclose to new accounts
		3. Issue written statement at least once per year to any account for which a periodic statement is issued
Missouri	Statute	1. First regularly scheduled mailing to all customers after law's enactment
		2. In writing to all new customers
		3. Posted notice of check hold limits
Montana	Statute	1. In first regularly scheduled mailing to all customers after law's enactment
		2. In first regularly scheduled maling to new customers

		3. Posted notice of check hold limits
New Jersey	Statute	1. Written notice after enactment
		2. Written notice to all applicants
New York	Regulation	1. In writing, to all customers
		2. Post notice in a conspicuous place in each manned branch
Oregon	Statute	1. In writing upon opening an account
		2. Notify each account holder 30 days prior to policy changes
		3. Post notice in a conspicuous place in each branch
Rhode Island	Statute	1. In writing, prior to opening a new account
		2. In writing to all customers within 3 months of law's effective date
		3. Deposit slip disclosure
Wisconsin	Statute	1. Written notice after enactment
		2. Upon written request
		3. In writing, upon initial deposit

*PA-84-164